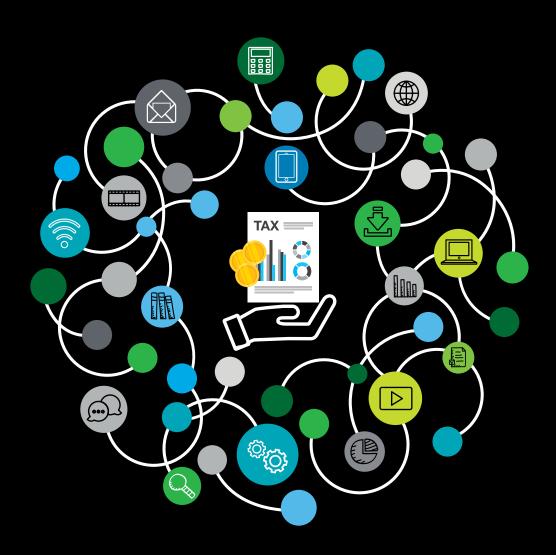
Deloitte.



Technology, Media, and Telecommunications

Tax Landscape

For Private circulation only

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Foreword by Deloitte

We are delighted to introduce you to our special tax publication for the Indian Telecommunication, Media, and Technology (TMT) industry.

India has done well to stay ahead of the curve in the technological revolution, redefining global value chains. India's hyper-competitive telecommunications sector has led the revolution from the front. As per various reports, the sectoral change in productivity has been the highest in the telecommunications sector since the 1991 reforms, outperforming the productivity growth of other sectors during this period. Consequently, telecommunications sector has also been one of the fastest growing sectors of the Indian economy, driven by affordable smartphones with high computing power, and cheap telephony, and mobile internet services, made possible with the emergence of 4G/LTE networks. These factors have propelled India to be the most watched telecommunications market in the world. This ongoing telecommunications revolution in the country also brought contemporary advancements in the media & entertainment and technology industries to the forefront, driving convergence of platforms, access, and the content ecosystem. Various advancements such as digitisation of content, ubiquitous broadband connectivity, and mobile first digital delivery channels opened up opportunities for leveraging digital platforms as a key interface for consumers across industries, making the digital economy a key pillar of the country's growth and development. Independently too, the media & entertainment sector exhibits strong growth drivers such as favourable demographics, increased sensitivities around news, sports, social messaging, digitisation of television distribution networks, and the digital transformation of print and radio. Key growth drivers for the technology sector include digital transformation beyond traditional IT

services, greater application of digital

tools such as blockchain, IoT, Robotics, Artificial Intelligence, and the emerging domestic market opportunities in Digital India, Smart Cities, and Industry 4.0 initiatives.

This is an era of high man-machine interactions, where human intelligence is being augmented by machine intelligence. Coupled with an increasingly sensitive socio-economic and political environment, India is amidst a global reset where legislations, including tax, are being expeditiously aligned in line with business transformations. In this emerging ecosystem, it is imperative to have a fair overview of the legal contours of doing business. India is not only an attractive market for business opportunities, but also a hotspot for talent, technology, and entrepreneurial prowess. Inbound and outbound transactions centring India have increasingly cast additional responsibility on Indian tax administrators to monitor and counter tax base erosion and ensure optimum collection of taxes within the boundaries of Indian tax laws. Since legislations could at times be an imperfect expression of the lawmakers' intent, controversies in interpretation are inevitable. Especially in a dynamic sector like TMT, the complexities associated with evolving business models and technologies make it imperative for stakeholders to be well-informed of key developments impacting the sector at large, and businesses in specific.

In light of the above, this tax publication aims to track key aspects including developments in the Indian tax regime impacting the TMT industry. It also provides an overview of the key tax rulings, which businesses in the TMT industry need to be mindful of while doing business in or with India. This publication is not a compilation of tax laws or guidance including judicial precedents relevant to the TMT space. We hope that you find it valuable.



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Technology, Media, and telecommunications: Sector overview

The Telecommunication, Media and Technology (TMT) industry has been witnessing phenomenal growth and transformation in the past few decades, and this trend is expected to continue in the future. As per publicly available reports, the Indian TMT industry is expected to grow beyond half a trillion dollars by 2021.

Telecommunications

Affordable smartphone prices and greater broadband speeds have propelled the Indian mobile market to a global high while the telecommunications sector is amidst a consolidation phase. The current policy framework and the emergence of 4G/LTE have led to strategy shifts in the telecommunications market. Amidst a continuously swelling telecommunications subscriber base using wireless technology, telecommunications players are either looking to merge, exit, or invest additional capital to survive and thrive in this competitive marketplace. The urban market in the country is witnessing adoption of the convergence technologies towards smart living. This is the consumer segment where IT and telecommunications will collaborate further for developing solutions, wherein intelligent networks driven by smart applications will focus more on getting luxury and comfort to potential users. For telecommunications players in this already matured market, network

experience is the most critical driver of customer experience and cause of churn in the telecommunications market. Internet telephony, mobile broadcasting, spectrum trading and auctions, interconnection capabilities through networks including satellite and undersea, investments in 5G for supporting wi-fi calling, mobile apps, cloud-based infrastructure and systems, digital payment platforms, etc., are some of the constantly evolving areas in the Indian telecommunications industry. Admittedly, the sector administrators and regulators such as Department of Telecommunications (DoT), Ministry of Information and Broadcasting (MIB), and the Telecommunications Regulatory Authority of India (TRAI) are also constantly evolving their approach often in consultation with the industry ecosystem towards managing and regulating this dynamic industry.

Media and Entertainment

Digitalisation of TV signals coupled with lower carrier costs and rise in the number of consumer households have made the media and entertainment (M&E) industry sensitive to new opportunities and challenges. Content, be it in print or digital form, when powered by the continuously evolving mobile technology generates phenomenal opportunities for all market players. India has been one of the largest movie producer countries in the world for the last few years,



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releasing more than a thousand films each year. The country is home to one of the most important cities in the global film industry, led by Mumbai, originally called Bombay and thereby synonymous with "Bollywood". The Indian film industry, supported by a movie-obsessed population and highest number of films produced, ought to reflect a dominant subset of the TMT industry in specific and the economy at large. In the face of severe under-screening, piracy issues, sub-par theatres, which constrains Indian film industry's gross revenue, the country is brimming with opportunities in development of theatrical infrastructure, digital content, entertainment parks, and technology platforms, besides the core cinematographic domain. These factors coupled with the burgeoning telecom subscriber base in India offers an unmatched growth potential for players in the Indian M&E space, from businesses to individuals. Bollywood found mention even in the 2019 Interim Budget. Complimenting the recently released film on surgical strikes, "Uri" and also underlining the need for a strong defense framework for India, Union Minister Piyush Goyal proposed that there will be a single window clearance (so far limited to foreign film makers) for Indian filmmakers and anti-camcorder regulations will be introduced in the Indian Cinematograph Act to prevent piracy. This single window clearance system shall also save pre-production time for film makers and boost tourism in some manner. The over the top video (OTT) market ecosystem has expanded with multiple industry stakeholders, such as broadcasters, pay TV operators, content aggregators, production houses and telecom companies, in the race for content distribution. Content producers, broadcasters and consumers are acclimatising to the

growing attractiveness of OTT/Digital platforms. Television as a medium is expected to further grow as permeation and digitisation increases, and the rise of high-speed data networks, cheaper and smarter devices is expected to fuel the growth of Video on Demand (VoD) services in the near future.

Technology

India's technology industry is going through a fundamental shift, driven by rapidly evolving market dynamics and the shift towards digital services. India is one of the top sourcing destinations for technology services in the world, with strong capabilities across the IT-BPM segments. In the last few years, as the export market faces headwinds such as softening demand for traditional services, and visa restrictions in the western markets, new opportunities are emerging in the domestic market, and in exponential technologies such as artificial intelligence (AI) machine learning, robotics, automation, etc., where India has a significant potential to lead the world. The domestic market in India is also one of the fastest growing markets in APAC driven by the ongoing large scale digital transformation of public sector and private sector enterprises, and our vision to be trillion-dollar digital economy by 2022. The Indian Government aims to transform 1 lakh villages into digital villages (DigiGaons) over the next five years under its ambitious Digital India programme, as proposed by the Union Minister Piyush Goyal while presenting the Interim Budget 2019. According to Mr. Goyal, this target would be achieved by expanding the Common Service Centres (CSCs), set up under the Ministry of Electronics and IT for delivery of essential utility services and government schemes, through installation of digital infrastructure in the villages.



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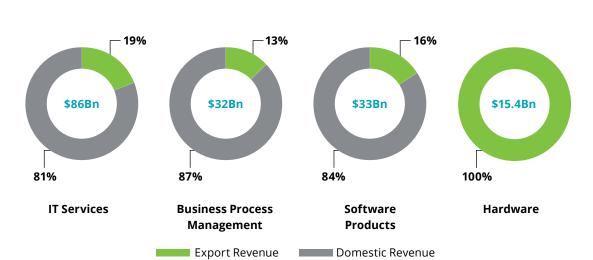
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The Indian IT industry is categorised under four major segments: IT Services, Business Process Management (BPM), Software Products, and Hardware.

- IT Services form the biggest segment, contributing more than half of the industry's revenue. The segment has a market size of USD 86 billion, with 81% of the revenue coming from exports.
 BFSI has been the largest vertical under this segment for a few years.
- Business Process Management (BPM) is estimated to be worth USD 32 billion

- with 87% of revenues coming from exports. Revenues are expected to grow to USD 54 billion by 2025.
- Software Products grew over 10.5% in FY17 to reach USD 33 billion. This constitutes ~20% of the industry's revenue, while exports contribute 84% to the segmental revenues.
- Hardware is the only segment where the domestic sales outrank export sales. The market is pegged at USD 15.4 billion.



The Indian IT sector can be classified into the following broad categories: IT Services, IT-Enabled Services (ITES)/ Business Process Outsourcing (BPO) Services and Engineering Services. IT Services can further be classified as information services, outsourcing software support and installation, systems integration, processing services, hardware support and installation and IT training and education. ITES are those that use the internet and telecom. For example, remote maintenance, back office operations, data processing, call centers, BPO, etc.,

the IT sector is attracting considerable interest not only as a vast market but also as potential production base by international companies. Therefore, India is considered as a pioneer in software development and a favourite destination for ITES. The rapid growth in the ITES domain is a consequence of access to trained English speaking professionals, cost competitiveness and quality telecommunications infrastructure. Companies setting up back offices in India are able to leverage the advantage of the Indian time zone to offer round the clock services to their global customers.



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Engineering Services include industrial design, mechanical design, electronic system design (including chip/board and embedded software design), design validation testing, industrialisation, and prototyping.

With speed of development in this sector, the above classifications within the technology sector may need to be revisited. The convergence of the digital and physical worlds is expected to make this change inevitable in the future. When buildings, vehicles, civic amenities, and associated infrastructure and platforms get inter-connected and interact through digital or other similar means with humans, it becomes a Smart City. Smart cities are key applications of the IoT ecosystem, where business models shall require a fundamental shift, from product-centric to experiencecentric models. Operations dependent on one-time product sales will evolve as business value moves from products to the experiences they enable. This transformation will fundamentally change how businesses operate, interact with customers and earn revenue.

Another disruption is the blockchain technology, originally developed as the accounting method for the virtual currency Bitcoin, a game changer in the distributed ledger technology (DLT) that is finding applications in a wide variety of commercial applications today. Currently, the technology is primarily used to verify transactions, using digital or cryptocurrencies, as opposed to fiat currencies. Transactions using the blockchain platform create an indelible record that cannot be changed; furthermore, the record's authenticity can be verified by the distributed network using the blockchain instead of a single centralised authority. Since blockchain not only records a transaction or data but also verifies the

same, it witnessed applications in supply chain, smart contracts, file storage, IPs, energy management, stock trading, governance, land registrations and even healthcare and banking. While India has not yet approved cryptocurrencies as legal tender similar to government-regulated fiat currencies, blockchain as a technology is being focused on as a potentially beneficial technology.

Artificial intelligence (also machine intelligence, MI) is intelligence demonstrated by machines, in contrast to the natural intelligence (NI) displayed by humans and other animals. In computer science, AI research is defined as the study of "intelligent agents": any device that perceives its environment and takes actions that maximise its chance of successfully achieving its goals. Colloquially, the term "artificial intelligence" is applied when a machine mimics "cognitive" functions that humans associate with other human minds, such as "learning" and "problem solving". Augmented Reality (AR) may not be as exciting as a virtual reality roller coaster ride, but the technology is proving as a very useful tool in our everyday lives. From social media filters, to surgical procedures, AR is rapidly growing in popularity because it brings elements of the virtual world, into the real world, thus enhancing things we see, hear, and feel. When compared to other reality technologies, augmented reality lies in the middle of the mixed reality spectrum; between the real world and the virtual world.

As per various research reports, more than 60% of all broadband subscribers would be utilising Voice over LTE (VoLTE) technology for voice services by 2023, surpassing 5 billion telecommunications subscribers globally. India, with an ever increasing subscriber base, would prove to be one of the leading markets for



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VoLTE. Coupled with IoT appliances and applications, these technologies are all set to put India as one of the global hot spots. Besides the above, technologies such as Robotics Process Automation (RPA) have been gaining traction as a way of automating repetitive, tedious tasks. Financial institutions, retailers, BPOs and others have started using RPA. As businesses embrace automation, India shall grow sizably on quantum of RPA jobs within 2021. As India sets out to embrace Industry 4.0, a blend of the cyber physical systems through a fair play of automation, is expected to be an important trend. Industry 4.0 creates "smart factory" for digital manufacturing. In the Industry 4.0 ecosystem, the modular structured smart factories, cyber-physical systems monitor physical processes and create a virtual copy of the physical world through decentralised decisions. Using the IoT platforms and cloud computing, cyber-physical systems communicate and cooperate with each other and also with humans in real time. Both internal and cross-organisational services are offered and used by participants of the value chain. Success of this fourth industrial revolution coupled with smart cities would fulfill the mission of "Digital India".

The India TMT industry has been witnessing consolidations and expansion exercises since long. High profile transactions in this space underline the potential and challenges facing the TMT

industry always. Since, these transactions measure the pulse of the TMT industry, tracking them becomes imperative for all players in this space.

Tax is one of the many regulations, which impact the TMT industry. Understanding various businesses and evaluation of the tax implications of the business model are constants for survival and growth. While the evolution of business in the TMT industry may outpace the evolution of the tax law alongside, it is of fundamental importance to carefully evaluate tax implications of the evolving business trends at all times, essentially due to the increasing trend of broad-ended tax legislations seeking to encapsulate digital and nondigital transactions. Increasing focus on countering tax base erosion and effecting widening of tax base through domestic and international tax law changes underline the need to closely monitor the developments in the domestic and international tax landscape. To illustrate, the recently introduced GST has revamped the Indian indirect taxation structure from origin based to destination based consumption tax with specific focus on jurisdictions. This is a critical move for TMT space which is characterized by innovative products, multiple recipients, multiple serving points and intangible nature of offerings. Developments in the taxation of digital economy are other aspects to ponder over, in this dynamic TMT space.



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Tax provisions: Applicable to the Indian TMT industry

The Technology, Media, and Telecommunications (TMT) industry remain as fascinating as ever. Evolving business models, efficient policy changes coupled with effective implementation are the need of the hour as they play a pivotal role in the sustenance, promotion, and growth of the TMT industry.

The taxman has been armed with various provisions to tax incomes and gains from the TMT industry. Further, various laws have been amended from time to time, including the Income-tax Act, 1961, Goods and Services Tax Acts, 2017 either to curb tax leakages/tax avoidance or enlarge the scope of existing provisions.

Income Tax

Scope of total income

Section 5 of the Act provides for charge of income-tax on the total income of every person. While residents are taxed on their worldwide income, non-residents, are only taxed on income (i) received/deemed to be received in India and (ii) income accruing/arising or deemed to accrue/arise in India.

Tax residency of companies

As per the provisions of the Act, a company is said to be resident in India if:

- a. It is an Indian company incorporated in accordance with the Companies Act 2013; or
- b. Its place of effective management for the year is in India.

The concept of "Place of Effective Management" (PoEM) was introduced by Finance Act 2016 to be applicable from 1 April 2017 i.e., from AY 2017-18 and subsequent assessment years. PoEM has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

CBDT vide Circular 6 of 2017 issued guidelines for determination of PoEM of a foreign company, which were broadly bifurcated into two parts i.e. companies meeting active business test and others. Further, CBDT has clarified that the PoEM guidelines shall not apply to companies having turnover or gross receipts of INR 50 crores or less in a financial year.

Meaning of active business outside

"Active business outside India" (ABOI)-A company is engaged in ABOI if the following conditions are met:

- Passive income is not more than 50% of its total income.
- Less than 50% of its total assets are situated in India.
- Less than 50% of total number of employees are situated in India or are residents in India.
- Payroll expense incurred on such employees is less than 50% of total payroll expense.

Other aspects

 In case of a company engaged in active business outside India, PoEM shall be presumed to be outside if majority of the board meetings are held outside India.



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- If it is established that powers of management are exercised by the holding company resident in India, then the PoEM shall be in India.
- Following general group policies would not constitute a PoEM in India.

In light of the provisions of Section 115JH of the Act dealing with foreign company said to be resident in India CBDT vide notification no. 29/2018, has issued guidelines on tax consequences for foreign company treated as resident in India on account PoEM. The guidelines provide for 40% tax rate, treatment/ calculation of brought forward business loss and unabsorbed depreciation, allowance of foreign tax credit (FTC), manner of computing depreciation on assets of the foreign company and compliance of TDS provisions (under Chapter XVII-B of the Act) etc.

For companies other than those having active business outside India, the following factors are relevant:

01. Location of meeting of the company's Board

- The location where a company's Board meets regularly and makes decisions would be relevant provided that the Board:
- Retains and exercises its authority to govern the company; and
- Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.
- If the key decisions by the directors are being taken in a place other than the place where the formal meetings are being held, then such other place would be relevant for the determination of PoEM.

02. Executive committee

PoEM would be determined based on the location of the person to whom the powers are delegated to make the strategic business decisions.

03. Location of the head office of a company

- Company where senior management is based out of single location.
- Company where senior management is decentralised i.e., operates from different places, then location of head office will be:
- Where senior management is primarily and predominantly based;
- Where senior management typically returns to following travel to other locations; and
- Where senior management meets while formulating key strategic decisions.
- Where it is difficult for the company's head office, then location would not be relevant.

04. Meetings via telephone or video conferencing

Place where the directors or the person taking the decisions or majority of them usually reside, may be relevant.

05. Shareholders activity

The decisions which typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective. Shareholder's activity pertaining to company law is not relevant for PoEM.

06. Circular resolution or round robin voting

The location of the person who has the authority and who exercises the authority to take decisions would be more important in determination of PoEM.

Recently, CBDT vide notification no. 29/2018, has issued guidelines on tax consequences for foreign company treated as resident in India on account of PoEM. The guidelines provide for



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40% tax rate, treatment/calculation of brought forward business loss and unabsorbed depreciation, allowance of FTC, manner of computing depreciation on assets of the foreign company and compliance of TDS provisions (under Chapter XVII-B of the Act).

Income deemed to accrue or arise in India

Concept of business connection

As per the provisions of the Act, income accruing or arising from the following would be deemed to accrue or arise in India:

- From business connection in India; or
- From any property in India; or
- Any source of income in India; or
- Through the transfer of a capital asset situate in India.

As per Explanation 2 to section 9(1)(i) of the Act, "business connection" means any business activity carried on through a person who on behalf of the nonresident:

- Habitually concludes contracts and plays the principal role leading to the conclusion of contracts.
- Does not conclude contract, but habitually maintains a stock of goods in India or merchandise from which he regularly delivers goods or merchandise.
- Habitually secures orders in India, mainly for the non-resident or for other non-residents under a common management.

Finance Act 2018, through Explanation 2A to section 9(1)(i) of the Act has introduced the concept of "significant economic presence", which provides that any of the following activity would constitute business connection in India of the non-resident:

 a. Transaction in respect of any goods, services or property carried out by a non-resident in India including

- provision of download of data or software in India (provided the revenue therefrom exceeds monetary threshold as may be prescribed).
- Systematic and continuous soliciting of business activities or engaging in interaction with users (exceeding the number as may be prescribed) in India through digital means.

The above provisions would be applicable irrespective of whether or not the agreement is entered in India or the non-resident has a residence or place of business in India or renders services in India, or not.

Under the amended definition, downloading of data or software, or solicitation of business activities through digital means in India could lead to income arising in India for the non-residents.

It has been further clarified that, only so much of income as is attributable to the specified transactions or activities, is to be deemed to accrue or arise in India.

Explanation 5 to section 9(1)(i) of the Act provides that an asset being share in the company/entity registered/incorporated outside India, shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Explanation 6 to section 9(1)(i) of the Act, clarifies meaning of "substantially derive value", which stated that (i) the value of the Indian assets must exceed INR 10 crores; and (ii) represent at least 50% of the value of assets owned by the foreign company whose shares are being directly or indirectly transferred.

Explanation 7 to section 9(1)(i) of the Act provides a carve-out for transfers of shares of a foreign company deriving substantial value from Indian assets by investors who hold less than 5% of the



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interest in such foreign company. Manner of computation of income of non-residents in certain cases is provided under Rule 10. Further, rules 11UB and 11UC and Form 3CT provide for determination of value of assets and apportionment of income in certain cases.

Interest

Interest income shall be taxable in India if it is received from government or resident, except for business of non-resident outside India or non-resident, where interest is payable for business carried on by such person in India.

Royalty

Royalty shall be taxable in India if it is received from government or resident, except for business of non-resident outside India or non-resident, where royalty is payable for business carried on by such person in India.

Explanation 2 to section 9(1)(vi) of the Act, provides the meaning of royalty, which is "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for:

- a. The transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- d. The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- The use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

- f. The transfer of all or any rights
 (including the granting of a licence)
 in respect of any copyright, literary,
 artistic or scientific work including
 films or video tapes for use in
 connection with television or tapes
 for use in connection with radio
 broadcasting, but not including
 consideration for the sale, distribution
 or exhibition of cinematographic
 films; or
- g. The rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

Explanation 4 to section 9(1)(vi) of the Act has clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 6 to section 9(1)(vi) of the Act has clarified that the term "process" used in the definition of royalty includes transmission by satellite, cable, optic fibre or by any other similar technology, whether such process is secret or not. The same is effective from 01 June 1976.

Fees for technical services (FTS)

FTS shall be taxable in India if it is received from government or resident, except for business of non-resident outside India or non-resident, where FTS is payable for business carried on by such person in India.

Explanation 2 to section 9(1)(vii) of the Act provides meaning of FTS, which means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or income chargeable under the head "Salaries".



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Explanation to section 9(1) provides that, income interest, royalty and FTS in case of a non-resident shall be deemed to accrue or arise in India whether or not the non-resident has business or business connection in India or the services in India by the non-resident.

Rate of tax on income from interest, royalty, and FTS in case of non-resident

Interest received from government or an Indian concern on monies borrowed or debt incurred in foreign currency other than interest from infrastructure debt fund or from specified company or business trust as specified under section 194LC of the Act, shall be taxable at the rate of 20% plus applicable surcharge and cess without allowing any expense incurred for earning such interest.

Income from royalty or FTS other than as specified in section 44DA of the Act, received from government or an Indian concern shall be taxable at the rate of 10% plus applicable surcharge and cess allowing any expense incurred for earning such income.

Deduction for newly established undertakings in Special Economic Zones (SEZ)

As an incentive to manufacturers and producers, section 10AA provides for a deduction of export profits up to 100% for the first five AYs and 50% for the next five AYs in case of an undertaking, which begins to manufacture or produce article or things or computers software in any SEZ. The further deduction of 50% of profit provided an equivalent amount is debited to the profit and loss account and

credited to Special Reserve Account for the next 5 AYs.

The above deduction is subject to certain conditions. Export profits eligible for deduction shall be computed as under:

Profits of the business of the undertaking Export turnover of the undertakings

Total turnover of the business carried on by the undertaking

Export turnover is the consideration from export received in, or brought into India by the assessee in convertible foreign exchange (within a period of six months), but it excludes freight, telecommunication charges, insurance attributable to delivery outside India and expenses incurred in foreign exchange in providing the technical services outside India.

Section 10AA is a deduction and not an exemption. Therefore, losses and depreciation of undertaking to which section 10AA applies shall be carried forward normally. Further, with effect from AY 2018-19, it has been clarified that deduction shall be allowed from the total income of the assessee before giving effect to the provisions of section 10AA of the Act and the deduction cannot exceed such total income. Further, the deduction under section 10AA shall not be allowed to units, which begins to manufacture or produce articles or things or provide any services on or before the first day of April 2021.



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Expenditure on scientific research

Section	Nature	Quantum of deduction
Section 35(1)(i)	Deduction of expenditure (not capital expenditure) laid out or expended on scientific research related to business.	Deduction of 100%
Section 35(1)(ii)	Weighted deduction from business income of any sum paid to an approved scientific research association, which has the object of undertaking scientific research. Similar deduction is also available if a sum is paid to an approved university, college or other institution and if such sum is used for scientific research.	Weighted deduction of 150% from 01.04.2017 to 31.03.2020 (i.e. PY 2017-18 to PY 2019-20); and deduction shall be restricted to 100% from 01.04.2020 (i.e. from previous year 2020-21 onwards).
Section 35(1)(iia)	Weighted deduction from the business income of any sum paid as contribution to an approved scientific research company.	Deduction shall be restricted to 100% with effect from 01.04.2017 (i.e. from PY 2017-18 and subsequent years).
Section 35(1)(iii)	Weighted deduction from the business income of contribution to an approved research association or university or college or other institution to be used for research in social science or statistical research.	Deduction shall be restricted to 100% with effect from 01.04.2017 (i.e. from previous year 2017-18 and subsequent years).
Section 35(2AA)	Weighted deduction from the business income of any sum paid to a National Laboratory or a university or an Indian Institute of Technology or a specified person for the purpose of approved scientific research programme.	Weighted deduction shall be restricted to 150% from 01.04.2017 to 31.03.2020 (i.e. from PY 2017-18 to PY 2019-20) Deduction shall be restricted to 100% from 01.04.2020 (i.e. from previous year 2020-21 onwards).
Section 35(2AB)	Weighted deduction of expenditure (not being expenditure in the nature of cost of any land or building) on scientific research on approved in-house research and development facility; incurred by a company engaged in the business of bio-technology/manufacture or production of any article or thing except some items appearing in the negative list specified in Schedule-XI.	Weighted deduction of 150% from 01.04.2017 to 31.03.2020 (i.e. from PY 2017-18 to PY 2019-20). Deduction shall be restricted to 100% from 01.04.2020 (i.e. from PY 2020-21 onwards).

Expenditure on know-how

Section 35AB provides that lump sum consideration paid for acquisition of technical know-how is eligible for deduction in six equal installments commencing from PY of payment of such consideration. If the acquired technical know-how is developed in any Indian laboratory, university or institution referred under section 32A, consideration paid shall be written off in three equal instalments.

Amortisation of expenditure for purchase of spectrum

Newly introduced section 35ABA of the Act (effective from 1st April, 2017) provides that capital expenditure incurred and actually paid for acquisition of "right to use spectrum" for telecommunication services shall be eligible for amortisation in equal instalments over the tenure of the right.



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If spectrum is transferred and proceeds of transfer exceed the amount of expenditure remaining unallowed, excess amount (to the extent it does not exceed deduction claimed u/s 35ABA) shall be chargeable to tax as profits and gains of business in the previous year in which such spectrum has been transferred. Unallowed expenditure in a case where a part of spectrum is transferred would be amortised.

Amortisation of expenditure for purchase of license

Capital expenditure incurred and paid for acquiring a license to operate telecommunication services shall be eligible for a deduction under section 35ABB of the Act in equal instalments over the period of the license.

On sale of license, excess of unamortised expenditure over capital sum realised from transfer shall be an allowable deduction. Likewise, excess of capital sum realised over unamortised expenditure shall be chargeable to tax as income under the head Profits and gain of business and profession but it shall not exceed the amount which has been written off so far.

Further, in case any part of the licence is sold and money realised is more than the unallowed amount and the excess amount does not exceed the amount allowed so far, such excess shall be taxable as business profits. If the amount realised does not exceed the unallowed value, the difference can be written off in remaining number of years.

Income from Royalty or Fees for Technical Services (FTS) vis-à-vis PE of a nonresident in India

Royalty or FTS income of a non-resident, in respect of a contract entered with the government or an Indian concern, post 31 March 2003, from a business carried on in India through a PE is chargeable to tax as business income.

While computing such business income, no deduction is to be allowed towards any expenditure which is paid by the PE to its head office or expenditure which is not wholly or exclusively incurred for the business of such PE. Business income is taxable in the hands of non-residents at 40% (plus applicable surcharge and cess).

In connection with business of exploration of mineral etc. by any non-resident having PE in India, section 44BB of the Act is not applicable and the income shall be taxed as business income under section 44DA of the Act.

The non-resident is required to maintain books of account, get the same audited by an accountant and furnish the audit report along with the return of income in prescribed form No. 3CE (refer Rule 6GA).

Capital gains

Capital gains is a tax levied on gains arising on transfer of a capital asset. In order to tax gains under the head "Capital Gains", there must exist a capital asset, transfer of the capital asset and profit or gains arising from the transfer.

As per section 2(14) of the Act, capital assets means and includes land, building, house property, vehicles, patents, trademarks, leasehold rights, machinery, and jewellery. This includes having rights in or in relation to an Indian company. It also includes rights of management or control or any other legal right.

Section 2(47) of the Act, defines the term transfer in relation to a capital asset and it includes:

- Sale, exchange, compulsory acquisition under any law and relinquishment.
- Conversion of capital asset to stock in trade.
- Maturity or redemption of a zero coupon bond.
- Any transaction which has the effect of transferring an (or enabling the enjoyment of) immovable property.



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 Disposing of or parting with an asset or any interest therein or creating any interest in any asset in any manner whatsoever etc.

Section 47 of the Act, excludes certain transactions from the definition of "transfer". Thus, transactions covered under section 47 of the Act are not deemed as "transfer" and, hence, these transactions will not give rise to any capital gain, e.g. assets received as gifts by way of an inheritance or will, assets transferred in amalgamation or demerger, conversion of one security to another, etc.

The capital assets can be either "Short-Term Capital Asset" or "Long-Term Capital Asset". As per section 2(42A), if the shares and securities are held for a period not more than 24 months preceding the date of its transfer, such shares and securities will be treated as a short-term capital asset. If the taxpayer holds the shares and securities for a period exceeding 24 months, then such shares and securities will be treated as long-term capital asset.

In case of equity shares which are listed in a recognised stock exchange, units of equity oriented mutual funds, listed debentures and government securities, units of UTI and Zero Coupon Bonds', the period of holding for the asset to be considered as short-term capital asset will be 12 months instead of 24 months.

Section 48 of the Act provides for the manner of computing the capital gains which is summarised here under:

- Short-term capital gain = Full value consideration-(cost of acquisition + cost of improvement + cost of transfer).
- Long-term capital gain = Full value of consideration received or accruing – (indexed cost of acquisition + indexed cost of improvement + cost of transfer).
- Indexed cost of acquisition = Cost of acquisition X cost inflation index of the year of transfer/ cost inflation index of the year of acquisition.
- Indexed cost of improvement = cost of improvement X cost inflation index of the year of transfer/cost inflation index of the year of improvement.

Section 111A, 112 and 112A of the Act provides rate of tax to be charged on gains arising from transfer of a capital asset. The same is summarised hereunder:

Particulars	Short-term capital gains	Long-term capital gains	
Sale of listed securities like equity shares/ unit of an equity oriented fund/unit of business trust which attract STT			
All assesses	15%	• Exempt if capital gains till 31 January 2018.	
		 Post 31 January 2018-10%, if the gains > 1,00,000 	
Other Assets			
Firms including LLP	30%	20% with indexation or 10% without	
Resident Companies	30%	— indexation for listed securities/units/zero coupon bonds	
FIIs	30%	10%	
Foreign Companies	40%	20%/10%	

^{*}Note: The above rates shall be increased by applicable surcharge and cess.



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Income from other sources

Section 56 of the Act brings within taxation, net income which is not taxable under any other head of income specified in section 14 items A to E. Thus, section 56 is a residuary head of income.

Provisions of section 56(2)(viia) of the Act, are anti-abusive in nature. Such provisions are enacted to tax receipt of shares of closely held companies by a firm or a company, without consideration or for inadequate consideration, where the fair market value of the shares exceeds INR 50,000. The FMV has to be calculated in the manner as prescribed in Rule 11U and Rue 11UA of the Income tax Rules 1962.

Finance Act 2012, introduced section 56(2)(viib), for taxing the consideration received on issue of shares, received from any resident by a company in which public is not substantially interested, in excess of the fair market value. The said amendment is to curb tax avoidance on issue of share in excess of its FMV.

Subsequently, Finance Act 2017 has inserted section 56(2)(x), to extend the aforesaid anti-abuse provisions to all categories of assesses. The provisions are amended to provide that where any person receives specified property without consideration and its stamp duty value exceeds INR 50,000, the same would be subject to tax.

The new clause (x) envisages to tax the deemed gift of certain defined properties/assets in the hands of every person receiving such property/asset subject to certain exceptions as provided therein. Also, earlier in the hands of firm and a private company, the receipt of only unquoted shares of a private company was covered by deemed gift taxing provisions whereas now it covers all the defined properties/assets.

Further, prior to amendment by Finance Act 2018, the taxation of income from

capital gains, business profits and other sources arising out of transactions in immovable property, the sale consideration or stamp duty value, whichever is higher is adopted, difference is taxed in the hands of the purchaser as well as the seller.

Finance Act, 2018 has amended the provisions of sections 28, 43CA, 50C and 56 of the Act, to provide that no adjustment shall be made in a case where the variation is not more than 5% of the sale consideration.

Restriction on carry forward and setoff of losses of a closely held company

Section 79 imposes a condition on a closely held company to allow carry forward and set-off the losses of a particular year against the income of the succeeding year. Such carry forward and set-off is not allowed, unless the shares of the company carrying 51% of the voting power, on the last day of the previous year in which set off is claimed and on the last day of the year in which loss was incurred, were beneficially held by the same persons.

In the case of an eligible start-up (referred to in section 80-IAC), the aforesaid condition is said to be fulfilled if the loss pertains to the first seven years from the date of incorporation of the start-up and all the shareholders on the last day of the year in which the loss was incurred continue to hold the shares on the last day of the previous year in which the loss is to be set off.

Specific exemption has been provided to any change in the shareholding arising due to the death of a shareholder, or on account of transfer of shares by way of gift to any relative of the shareholder. Exemption has already been provided to an Indian company (being a subsidiary of a foreign company) where change in shareholding has occurred on account of amalgamation and demerger of the foreign company.



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Avoidance of double taxation

Section 90 empowers Central
Government to enter into Double Tax
Avoidance Agreement (DTAA) with
any country. It is a beneficial provision
whereby a relief is provided to the
foreign taxpayer from being doubly
taxed. It provides an option to the foreign
taxpayer of applying the provisions of
the Act or DTAA entered whichever are
more beneficial by providing documents
like Tax Residency Certificate, Form
10F, declaration of "No permanent
establishment" and "No Place of Effective
Management" in India.

However, in the absence of a DTAA between India and the relevant country, the chargeability of income would continue to be governed by the provisions of the Act.

Section 206AA mandates furnishing of PAN by the taxpayer to the person responsible for deducting tax, failing which tax is deducted at a higher rate. Rule 37BC introduced by CBDT notification no. 53/2016 F No. 370 142/16/2016 has relaxed this condition in case of non-resident taxpayers who do not have PAN on submission of prescribed details like Name, email id, contact number; address in country of residence; TRC and Tax Identification Number (TIN) in the country of residence.

As stated above, assessee can take beneficial provisions of the Act or relevant DTAA's. The key DTAA articles would include article on permanent establishment, business income, capital gains, royalty/FTS, income from other source, independent personal services and limitation of benefit clause. Further, since India is a signatory to the MLI, the relevant tax treaties would be required to be read with the MLI provisions, once they are become effective.

Taxation in case of non-resident sportsmen or sports associations

Income earned by non-resident sportsmen or entertainer, who are not citizens of India or non-resident sports association or institutions is taxed at 20% under section 115BBA of the Act. The income to be charged shall include money received or receivable by participating in a game/sport conducted in India, or advertisement or contribution to newspapers, magazines or journals relating to any sports in India.

The provisions of section 115BBA would be applicable to the guarantee money receivable by the non-resident sports association and also to the entertainer participating in any event in India.

This section provides a relaxation to the non-resident by exempting them from filing the return of income in India, where the total income of the non-resident only pertains to the aforementioned income and tax has been appropriately withheld from such income.

Patent box regime

Vide Finance Act 2016, India introduced a new patent box regime. Under Section 115BBF of the Act, worldwide income derived by an Indian resident patentee from a patent developed and registered in India is taxed on a gross basis at a concessional rate of 10% (option to be exercised in prescribed manner provided under rule 5G of Income-tax Rules, 1962 and Form No. 3CFA).

Withholding tax

Payment to contractors

Payment made to a resident contractor for carrying out any work including labour supply shall be liable to withholding tax at the rate of 1% in case of individual/ HUF and 2% in case of other persons. However, provision of section 194C will not be applicable if the payment does not exceed INR 1,00,000 in a financial year.

For the purpose of this provision, "work" includes:

Advertising, broadcasting and telecasting, carriage of goods/passengers (other than by railways), catering, manufacturing or supplying of a customised product by using material purchased from such customer are services covered under "work" for the purpose of this section.



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Payments to non-resident sportsmen or sports association

Payment to non-resident sportsman/ entertainer who is not a citizen of India or a non-resident sports association or institution of income referred to in section 115BBA of the Act shall be subject to withholding of tax at 20%.

Payment of commission or brokerage

Where remittance is made towards any income by way of a commission (not being insurance commission) or brokerage to a resident, tax is required to be withheld at the rate of 5% (in case of payments exceeding INR 15,000 in a financial year).

Explanation 1 to section 194H provides that for the purpose of this section, "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities.

Fees for profession or technical services

Section 194J of the Act provides for withholding of tax on any payment in excess of INR 30,000 made to a person resident in India for professional services, technical services, royalty, remuneration/fees/commission other than salary or any sum referred to in clause (va) of section 28 of the Act. The tax is required to be deducted at the rate of 10% of the gross amount (excluding indirect taxes).

For the purpose of section 194J,

 a. Professional services-means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section; b. Royalty and Fees for technical services

 It shall have the same meaning as
 in Explanation 2 to clause (vi) and
 (vii) of sub-section (1) of section 9

Tax deduction on payments to nonresidents (other sums)

Payment to a non-resident, of any interest (except interest referred to in section 194LB/section 194LC/ section 194LD) or any other sum that is chargeable under the Act (except salary and dividend income) is liable to tax withholding (TDS) under Section 195 of the Act at the time of credit or payment, whichever is earlier. Payer, the person remitting the payment to a non-resident, can be an individual, Hindu Undivided Family, firm, non-resident, foreign company or any persons having exempt income in India.

Under section 195, there is no threshold for deduction of tax. Accordingly, TDS is required to be deducted on the entire sum chargeable to tax. Further, crediting the sum to any interest payable/suspense account or an account called by any other name in the books of the payer; is considered as deemed to be credited to the non-resident and accordingly tax is deductible by the payer.

The tax is to be withheld at the relevant rate in force as per Chapter XVIIB of the Act. If the non-resident payee does not have a PAN, as per section 206AA, tax shall be withheld at the rate of 20% or rate specified as per the relevant provision under the Act or rates in force, whichever is higher. However, Finance Act 2016 inserted sub-section (7) to section 206AA, which provides that the higher rate of TDS shall not be applicable to payments made to non-residents, subject to conditions, as may be prescribed. The Central Board of Direct Taxes, vide notification dated 24 June 2016, inserted a new Rule 37BC to the Income-tax Rules, 1962, which provides that, section 206AA of the Act will not apply in respect of payments like interest, royalty, fees for technical services and payments on transfer of any capital asset even if



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the deductee has no PAN but furnishes the details and documents prescribed therein. Accordingly, the higher rate of 20% may be applicable only if the non-resident is not able to furnish the prescribed details/documents.

While calculating TDS rates we need to consider the provisions under Double Taxation Avoidance Agreement (DTAA) for the relevant country if any. In case payee fulfils all the conditions as prescribed in the DTAA then rates as per DTAA will apply. Generally, rates under DTAA will be lower than normal TDS rates.

In a situation where the whole of the sum payable to the non-resident is not chargeable to tax, section 195 of the Act provides for the payer to make an application to the jurisdictional tax officer for issuance of an order determining the tax deductible on the proportion of sum chargeable to tax. The section also provides for the recipient of any interest or other sum to make an application to the jurisdictional tax officer for the grant of a certificate whereby the recipient shall receive the interest/other sum without deduction of tax.

Limitation on interest deduction

Newly inserted section 94B of the Act, applicable with effect from 1 April 2017, limits the amount of interest deduction, claimed by an Indian company/PE of a foreign company which has borrowed funds from a non-resident Associated Enterprise (AE) to the lower of

- a. 30% of EBITDA (earnings before interest, taxes, depreciation and amortisation) of the borrower in PY.
- b. Interest paid or payable to AE for that PY.

Such excess interest disallowed in an AY shall be eligible to be carried forward for 8 AYs immediately succeeding such AY. Further, the provisions are only applicable on payment of interest exceeding INR 1 crore in respect of any debt issued directly from the AE of the borrower or

indirectly through a lender which is not associated but an AE has either provided an implicit/explicit guarantee or has deposited a corresponding amount of funds with the lender as security for the loan.

Minimum Alternate Tax (MAT) provisions to be aligned with IND-AS-Section 115JB

Provisions of Section 115JB were introduced to levy tax on zero tax companies which had profits in books, however, were not paying tax/marginal tax on account of various incentives or adjustments allowed under the provisions of the Act. The section provides for levy of tax on book profits at 18.5%.

Explanation 4 to Section 115JB (inserted with retrospective effect) has clarified that MAT is not applicable to foreign companies which do not have a permanent establishment in India.

MAT is payable only if tax as per normal provisions of the Act is less than 18.5% of "book profits".

The provisions provide for certain adjustments to the book profits, which need to be deducted or added to the book profits as shown in the profit and loss statement/account while computing book profit.

The tax paid on book profit will be allowed as credit to the assesse as per section 115JAA of the Act. The MAT credit allowable for a particular year is difference between tax computed as per normal provisions of the Act and MAT payable on book profits of that particular financial year.

MAT paid can be carried forward for a period of 15 years immediately succeeding the year in which MAT credit becomes allowable i.e. the year succeeding the year in which tax is payable under MAT provisions as per section 115JB of the Act.



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Assessee liable under the MAT provisions would be required to furnish a report from a Chartered Accountant in Form 29B. Such report is to be furnished electronically as per rule 12(2) wherein it shall be certified that book profits are computed as per Section 115JB of the Act.

Recently the MAT provisions are been amended pursuant to applicability of Indian Accounting Standards [Ind AS] to the specified companies from financial year 2016-17.

The broad framework for aligning Ind-AS compliant financial statements with MAT is as under:

- Net profits before other comprehensive income [OCI] to be considered as the broad starting point for MAT.
- Normal adjustments in computation of MAT as prescribed to be done.
- OCI items that will be permanently recorded in reserves (i.e. never to be reclassified to statement of profit and loss) to be included in book profits for MAT.
- Adjustments on account of transitional provisions that are recorded in OCI and would subsequently be reclassified to the statement of profit and loss, would be included in book profits in the year of reclassification.
- Transitional adjustments recorded in Reserves and Surplus, excluding Capital Reserve and Securities Premium Reserve, (i.e. never be reclassified to statement of profit and loss) to be included in book profits for MAT.
- Prescribed adjustments to be made in relation to demergers to be given effect to.

Pursuant to applicability of Indian Accounting Standards [Ind AS] to specified companies from financial year 2016-17, MAT provisions have been amended from assessment year 2017-18. Apart from current year adjustments, sum total of all the adjustments made till preceding financial year (transition Amount) shall be included in the book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS.

Equalisation levy

In line with recommendations of the OECD on BEPS Action Plan 1 and in order to provide clarity on taxability of such digital transactions, a new chapter titled "Equalisation Levy" has been inserted. It provides to impose a levy of 6% on gross consideration with respect to certain specified digital services.

The levy will be applicable on the payments received by a non-resident service provider from an Indian resident or an Indian Permanent Establishment ("PE") of a non-resident. The specified services means online advertisement, any provision for digital advertising space facilities/services for the purpose of online advertisement and includes any other service as may be notified by the government.

However, the levy would not be applicable when value of services is less than INR 1,00,000 or when the non-resident service providers is having a PE in India (as they will be subjected to a regular PE based taxation).

The equalisation levy deducted has to be deposited before 7th of the following month of deduction and an annual statement in Form 1 is required to be filed on or before 30 June of the next financial year.

GAAR provisions

GAAR provisions are effective from FY 2017-18, to examine certain arrangements that are primarily entered into with an objective of tax evasion or tax avoidance. Such arrangements generally do not have any commercial substance.

Section 96 of the Act defines an impermissible avoidance arrangement, as an arrangement, the main purpose of which is to obtain a tax benefit, and it:



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- Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length.
- Results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act.
- Lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part.
- Is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

Section 102 of the Act provides meaning of the term tax benefit as:

- Reduction or avoidance or deferral of tax/ amount payable under the Act.
- Increase in refund of tax/other amount under the Act.
- Reduction or avoidance/deferral of tax/ other amount that would be payable under the Act, as a result of tax treaty.
- Increase in refund of tax/other amount that would be payable under the Act, as a result of tax treaty.
- Reduction in total income.
- Increase in loss, in the relevant previous year or any other previous year.

Per the provisions of the Act, an arrangement would lack commercial substance if:

- The substance or effect of the arrangement as a whole, is inconsistent, with, or differs significantly from, the form of its individual steps or a part.
- It involves in round tripping, accommodating party, elements of offsetting/cancelling, disguises in value, party source, ownership or control of funds.
- It involves the location of an asset or of a transaction or of place of residence of any party which is without any substantial commercial purpose other than obtaining tax benefit.

 It does not have a significant effect upon the business risk or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit.

Consequences of an impermissible avoidance arrangements are:

- Disregarding, combining or re-characterising the whole or part of the arrangement.
- Treating the arrangement as if it has not been entered into.
- Disregarding any party or treating parties as one and the same person.
- Deeming connected persons to be one.
- Reallocating any income/ receipt and expenditure/deduction.
- Determining the place of residence or situs of asset or transaction.
- Disregarding any corporate structure.
- Treatment of equity as debt and vice versa.

Per Rule 10U, the provision of chapter X-A would not be applicable to the following:

- An arrangement where the tax benefit does not exceed INR 3 crores; further, it has been clarified that of INR 3 crores cannot be restricted to a single taxpayer alone and impact on all parties to the arrangement to be considered.
- A foreign Institutional Investor who:
 - is an assessee under the Act;
 - has not taken benefit of section 90/90A of the Act;
 - invested in listed securities/unlisted securities with prior permission of the competent authority/in accordance with SEBI Regulations and such other regulation as may be applicable.
- Investment by a non-resident person in offshore derivative instruments or other investment in a Foreign Institutional Investor.
- Income accruing/arising or deemed to accrue/arise, received/deemed to be received on transfer of investments made before 1 April 2017.



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Further, CBDT vide circular 7 of 2017 dated 21 January 2017, has clarified certain issues like applicability of GAAR and specific anti avoidance provisions in the Act, LOB clauses in the tax treaty, grandfathering of investments, etc.

Deduction in respect of expenditure on production of feature films – Rule 9A

Rule 9A of the Income tax Rules, 1962 allows a deduction in respect of the cost of production of feature films certified for release by Board of Film Censors in the previous year to the film producer.

In this case, where the feature film is certified for release on a commercial basis at least ninety days before the end of the previous year, the entire cost of production is allowed for deduction to the producer, if:

- a. he sells all the rights of exhibition of the film, or
- the film producer himself exhibits the film on a commercial basis in all or some areas, or
- c. he sells rights of exhibition in some areas, or
- d. he himself exhibits the film on a commercial basis in certain areas and sells the rights of exhibition of the film in respect of all or some of the remaining areas.

In a case, where the film is not released ninety days before the end of the previous year, the cost of production will be allowed such that it does not exceed the income earned by the producer from the release of the film (i.e. amount realised by exhibiting the film or from sale of rights or aggregate of the amounts realised by partly exhibiting and partly sale of rights); and the balance will be allowed as a deduction in the next following previous year.

Deduction under this rule is not allowed unless, the amount realised by the producer or minimum amount guaranteed is credited in the books of account maintained by him in respect of the previous year in which the deduction is admissible.

Further, in respect of abandoned films, the CBDT relying on the decision of Hon'ble Bombay HC in the case of Venus Records and Tapes Private Limited (ITA 310 of 2013) has clarified that Rule 9A does not apply to abandoned films.

Deduction in respect of expenditure on acquisition of distribution rights of feature films – Rule 9B

The computation of income earned from distribution of feature films carried on by a firm distributor is governed by Rule 9B of the Income tax Rules, 1962. The entire cost of acquisition is allowed as a deduction to the film distributor in a PY where the feature film is acquired by him and the film is released at least ninety days before the end of such previous years and he himself exhibits the film or he sells the rights of exhibition in all of some areas.

If the film is not released at least 90 days before the end of the previous year, the cost of acquisition allowable to the film distributor shall be restricted to the income earned from the distribution of the film. The balance, if any will be carried forward to the next following previous year and shall be allowed as a deduction in the year.

Cost of acquisition in the hands of the film distributor means the amount paid by the film distributor to the film producer/ another distributor under an agreement for acquiring the rights of exhibition.

Deduction under this rule shall not be allowed unless such amounts have been credited in the books of account maintained by the film distributor in respect of the year in which the deduction is admissible.



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In addition to the above provisions, the normative provisions like for computing business income, capital gains, assessment proceedings, appeal, revisions, penalties and prosecutions etc. would also be applicable to TMT industry.

Indirect Tax

Changes in tax rates for consumer goods in technology sector

To provide a boost to the Government's "Make in India" policy, the rate of basic customs duty on certain products in the technology industry such as mobile phones, smart watches and televisions has been increased in the last year, for example custom duty on mobile phones have been increased from 15% to 20% in 2018. This indicates clear move towards increased localisation efforts and backward integration on the tax rate front. As against the increase in custom duty on mobile phone in 2018, the Government has recently provided relief to specified imports. Lithium ion cell for use in manufacture of battery pack of cellular mobile phone, power bank of lithium ion, lithium ion accumulator will be subject to BCD @ 5%. Other parts and components and accessories (except PCBA) for manufacture of lithium ion batteries other than batteries of mobile handsets including cellular phones continue to subject to 'NIL' BCD rate.

Further, abolition of 3% Cess on imports (Education Cess and Secondary and higher education Cess) was replaced by a levy of 10% Social Welfare Surcharge vide Union Budget 2018. Introduction of the Surcharge has not adversely impacted the IT industry since majority of goods covered under WTO Information Technology Agreement which were exempted from Cess, continued to be exempted from the levy of Social Welfare Surcharge.

On similar lines, all the goods (including IT related goods) imported by EOU's and

STPI Units are also exempted from levy of custom duties and the said exemption is continued till 31.03.2019.

Export benefits to IT enabled services under Foreign Trade Policy

IT/ ITES sector has been one of key exporter of services in India and hence, there have been various foreign trade policy which have focussed their attention to this segment to maximise foreign exchange earnings for the country. In this backdrop it was striking to note that the Service Exporter from India Scheme, which was introduced on 1 April 2015, did not include the list of ITSS/ ITES services for extending benefits of exports to Indian tax payers. As a welcome move, recently a trade circular from DGFT Trade Notice No. 4/2018 - DGFT dated 25 April 2018 in relation to IT enabled services, it has been clarified that the service categories which has been notified in Annexure 3D for SEIS are allowed for claims and it is immaterial whether such services are derived from IT enabled platform or otherwise.

Clarification for place of supply under service tax for IT/ITES

Assessment of refunds under service tax regime have been made to suggest that a major part of IT / ITES services are not export, and therefore not eligible for refunds. As per the view of revenue authorities, the place of supply of services is in India and hence cannot be treated as export of services. In view of the above, a Circular Ref No. 209/1/2018-Service Tax dated 4 May 2018 was issued by the Ministry of Finance clarifying that the IT / ITES services are eligible for refund. It can be observed that the Government has been addressing the concerns of the industry specifically with respect to change from service tax regime to GST. Some of the challenges and issues which are open, are expected to be ironed out by continued engagement with relevant stakeholders.



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Evaluation of taxation on Online Information Database Acesss and Retrieval Services (OIDAR)

Moving on to OIDAR Services, it is relevant to note that prior to 1 December, 2016, OIDAR services provided by non-residents were not liable to tax in India, since place of provision of service was the location of service provider. However, effective 1 December 2016, the provision were amended vide Notification No. 46 to 48/2016 – Service Tax dated 9 November 2016 wherein the place of provision of service was prescribed as location of service recipient. This was a major shift in the taxation of digital supplies aligning the tax provisions to OECD guidelines to curb tax evasions.

In parallel, there were significant amendments made in service tax provisions relating to OIDAR services whereby the supplies were classified into two categories as B2B and B2C supplies. In case of cross-border B2B transactions, service recipient was required to pay taxes under reverse charge and in case of cross-border B2C transactions, which were earlier exempted (prior to December 2016) were now made taxable and the liability to pay tax was shifted on the non-resident service provider. Further, if intermediary located outside India facilitates cross-border OIDAR services then such person is liable for registration and payment of taxes in case of cross-border B2C services. In GST, the provisions on taxability remain same and there are no major changes.

This had mandated the non-resident OIDAR service providers making B2C supplies to register in India and undertake compliances under service tax. In GST regime, as per Notification No 2/2017-IGST dated 19 June 2017, OIDAR service provider located outside India, would have to obtain single registration with central jurisdiction located in Karnataka.

Composition Scheme Framework under GST for SMEs

While GST brought in various benefits to the Indian industries, composition scheme of taxation provided special ease to SMEs in various industries. IT industry at large is characterized by IT startups and SMEs in the initial stages of development especially IT hardware and IT goods. Following are key features of the scheme that the SMEs in IT segment benefit from:

- Eligibility to supplier of goods (involved in intra-state supplies) for composition scheme.
- Eligibility to businesses having annual turnover of less than INR 1.5 crores.
- Lower rate of 1% GST on turnover of taxable supply of goods to be paid without collecting from customers (No entitlement of ITC).
- Ease of paying GST liability on quarterly basis.
- Quarterly requirement of filing simplified GST returns.

Payment of GST on supplies made through e-commerce operator

While the person responsible to make payment of tax is generally the supplier (as it was in the earlier regime), the GST law as per Notification No. 17/2017-Central Tax Rate dated 28 June 2017 mandates an e-commerce operator to make payment of tax in respect of notified supplies. These supplies include transportation of passenger by a radio-taxi, motor-cab, maxi cab and motor cycle, services by way of providing accommodation in hotels, inns, guest houses, etc.



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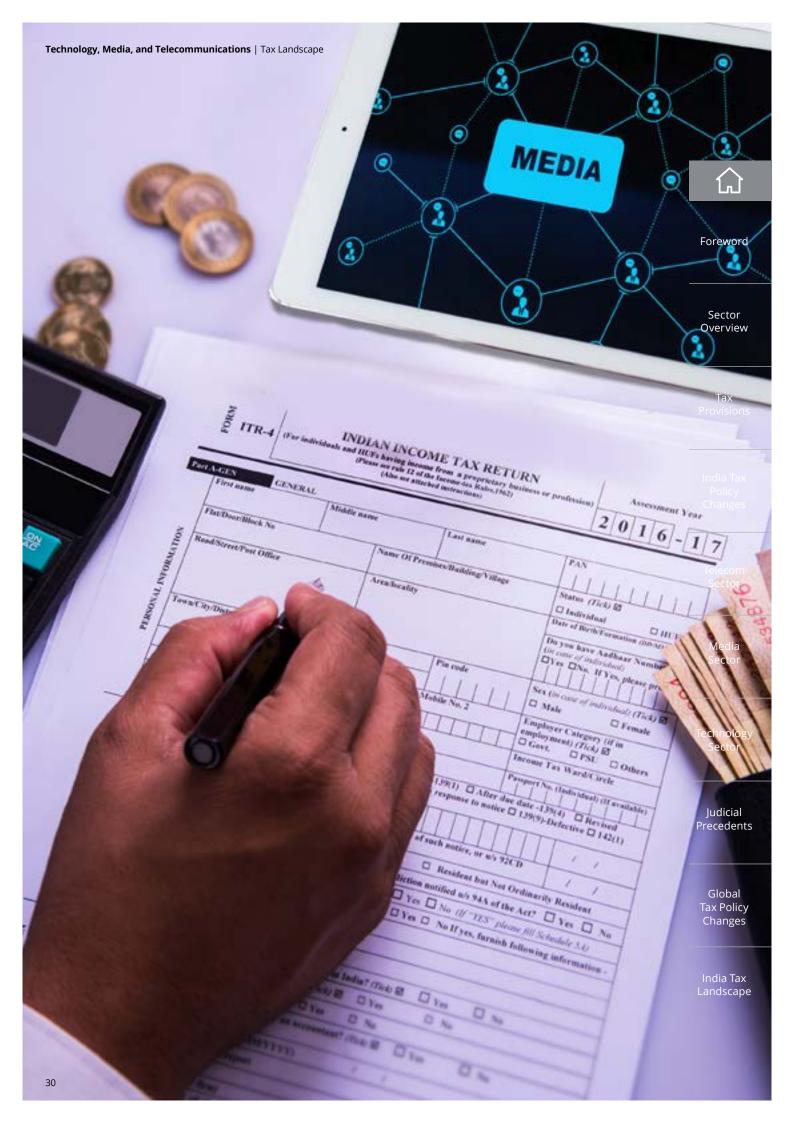
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India tax policy changes: Impact and implications

The Technology, Media, and Telecommunications sectors are among the most critical and constantly evolving segments of the Indian economy. With dynamic business models, efficient, and effective policy changes coupled with effective administrative and implementation, certainty has always been the need of the hour for sustained growth and development of all segments within the TMT industry.

The global tax policy changes signified by the OECD and UN, besides country specific policy measures, are increasingly aiming at a synchronised balance of domestic and international law. Additionally for every sovereign state, certainty and clarity to taxpayers are of immense importance to ensure economic stability and conducive investment climate.

Accordingly, the Income-tax Act has been amended from time to time to curb tax leakages. While the previous pages reflected on certain applicable tax provisions, through apparently repetitive, this section attempts to highlight certain key tax developments/amendments in the area of Technology, Media and Telecommunications (TMT) since 2012.

PoEM introduced as test of residence for foreign companies – Section 6(3)

The Finance Act, 2015 amended the definition of Resident companies under Section 6(3) of the Act to introduce the concept of "Place of

Effective Management" (PoEM). Foreign companies, having place of effective management in India in the previous year would be treated as resident in India.

"Place of effective management" has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

The Finance Act, 2016 deferred the PoEM provision to be applicable from 1 April 2017 i.e. from AY 2017-18 and subsequent assessment years.

CBDT vide Circular 6 of 2017 issued final guidelines for determination of PoEM of a foreign company, which were broadly bifurcated into two parts i.e. companies meeting active business test and others. Further, CBDT has clarified that the PoEM guidelines shall not apply to companies having turnover or gross receipts of INR 50 crores or less in a financial year.

CBDT vide notification no. 29/2018, has issued guidelines on tax consequences for foreign company treated as resident in India on account PoEM. The guidelines provide for 40% tax rate, treatment/calculation of brought forward business loss and unabsorbed depreciation, allowance of foreign tax credit (FTC), manner of computing depreciation on assets of the foreign company and compliance of TDS provisions (under Chapter XVII-B of the Act) etc.



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It is noteworthy, the international jurisprudence does not recognise PoEM test as an appropriate test of tax residency, any more.

Capital gains on indirect transfer of capital assets – Section 9(1)(i)

Finance Act 2012, retrospectively with effect from 01 April 1962, expanded the scope of deemed income for non-residents [u/s 9(1)(i)], to include income from transfer of share or interest in a company/entity registered/incorporated outside India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

The above amendment was to counter the Supreme Court judgement in case of Vodafone International Holdings B.V. vs Union of India, which held that the Indian tax authorities does not have jurisdiction for taxing offshore share transfers.

It has been clarified that the term "property" as used in the definition of capital asset includes any rights of management or control or any other rights whatsoever in relation to an Indian company.

Further, the indirect transfer law clarifies that an asset or a capital asset being a share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives directly or indirectly its value substantial from the assets located in India. CBDT issued a circular, clarifying that declaration of dividend outside India by a foreign company would not be taxable in India under the indirect transfer provisions enshrined under Section 9 since such declaration and payment of dividend does not have an effect of transfer of any underlying asset located in India.

Amendments to Section 9(1)(i)

Aligning the scope of "business connection" with modified PE rule as per Multilateral Instrument (MLI)

Provisions of section 9 of the Act have been amended to align the domestic laws with the provisions of the DTAAs as modified by MLI in order to make treaty provisions effective.

Accordingly, definition of "business connection" under section 9(1)(i) has been widened to include any business activities carried on through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts by the non-resident.

The contract is required to be in the name of the non-resident principal or for transfer of ownership or granting of right to use of property that is owned by the non-resident (owned or licensed) or for the provision of services by the non-resident. An exclusion for activities limited to purchase of goods or merchandise which was present under the present agency rule has been removed.

Incorporation of the concept of significant economic presence

The scope of existing provisions of section 9(1)(i) essentially provide for physical presence based nexus rule. OECD, under its BEPS Action Plan 1, addressed the tax challenges in a digital economy.

In view of BEPS Action Plan 1, provisions of section 9(1) (i) of the Act are amended to introduce the concept of "significant economic presence", which is defined as:

 Transaction in respect of any goods, services or property carried out by a non-resident in India including provision



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of download of data or software in India (provided the revenue therefrom exceeds monetary threshold as may be prescribed).

 Systematic and continuous soliciting of business activities or engaging in interaction with users (exceeding the number as may be prescribed) in India through digital means.

Whether or not the non-resident has a residence or place of business in India or renders services in India is not relevant.

Only so much of income as is attributable to the specified transactions or activities is to be deemed to accrue or arise in India.

Amendment in the definition of Royalty – Section 9(1)(vi)

The Finance Act, 2012, attempted to nullify the effect of certain rulings on what constitutes 'Royalty income' in India by inserting certain clarificatory explanations with retrospective effect.

Computer software

The Finance Act 2012 amended the definition of royalty to clarify that it specifically covers the use or right to use computer software (including granting of a licence). Medium of transfer is not relevant for determining taxability. The said amendment was through insertion of explanation 4 to section 9(1)(vi) made applicable retrospectively from 01 June 1976.

Bandwidth/Satellite transmission

The Finance Act 2012, clarified that the term "process" used in the definition of royalty includes transmission by satellite, cable, optic fibre or by any other similar technology, whether such process is a secret or not. The amendment is effective retrospectively from 01 June 1976.

Phasing out of weighted deductions

The Finance Minister in his Budget Speech, 2015 had indicated that the corporate tax rate for existing Indian companies shall be reduced from 30% to 25% over the next four years along with corresponding phasing out of exemptions and deductions. In view thereof, it has been provided to phase out several incentives available under section:

- Section-10AA-Deduction for newly established SEZs.
- Section-35(1)(ii), 35(1)(iia), 35(1)(iii), 35(2AB)-Expenditure on scientific research.
- Section-35AC-Expenditure on eligible project or scheme for promoting the social and economic welfare, or upliftment of general public.

Amortisation of expenditure for purchase of spectrum – Section 35ABA

Section 35ABA was introduced with effect from 1 April 2016 to provide for amortisation of expenditure incurred for acquisition of 'right to use spectrum' over the tenure of the right. Capital expenditure incurred and actually paid for acquisition of right to use spectrum for telecommunication services is allowed as a deduction in equal instalments over the period of the right.

Extension of anti-abuse provisions to tax receipt of sum of money or property without consideration or for inadequate consideration-Section – 56(2)(x)

Anti-abuse provisions provide to tax receipt of sum of money or immovable property or specified movable property, without consideration or for inadequate consideration where deficit exceeds INR 50,000, as 'income from other sources', in the hands of the recipients being individuals or Hindu undivided family.

These anti-abuse provisions also provided for taxability of receipt of shares of closely held companies by a firm or a company, without consideration or for inadequate consideration, where the fair market value of the shares exceeds INR 50,000.



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Finance Act 2012, introduced Section 56(2)(viib), for taxing the consideration received on issue of shares, received from any resident by a company in which public is not substantially interested, in excess of the fair market value. The said amendment is to curb tax avoidance on issue of share in excess of its FMV.

Finance Act 2017 has inserted section 56(2)(x), to extend the aforesaid antiabuse provisions to all categories of assesses. However, in this regard, certain exceptions have been specifically provided.

Limitation of interest deduction in certain cases-Section 94B

In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted to provide that deduction in respect of interest expense paid by an entity to its Associated Enterprises (AE) shall be restricted to lower of (i) 30% of its EBITDA; or (ii) interest paid/payable to AE. Provisions are applicable where interest or similar consideration to its AE exceeds INR 1 crore.

The said provision is applicable to Indian company, or a PE of a foreign company in India, being the borrower, who pays interest or similar consideration in respect of any debt issued by a non-resident AE (not to apply to company engaged in the business of banking/insurance).

Equalisation levy

B2B e-commerce transactions include digital/online market place services, online advertisement, and services for the purpose of online advertisement. Digital economy has poised various challenges in taxability of e-commerce transactions.

Under the BEPS Action Plan 1, the OECD has considered Equalisation Levy as one of the modes of taxing the digital transactions.

In line with recommendations of the OECD and in order to provide clarity on taxability of such digital transactions, a new chapter titled "Equalisation Levy" has been inserted. It provides to impose a levy of 6% on gross consideration with respect to certain specified digital services.

The levy will be applicable on the payments received by a non-resident service provider from an Indian resident or an Indian Permanent Establishment (PE) of a non-resident. However, the levy would not be applicable when value of services is less than INR 1,00,000 or when the non-resident service providers is having a PE in India (as they will be subjected to a regular PE based taxation).

Income Computation and Disclosure Standard (ICDS)

List of 10 ICDS have been introduced with effect from 1 April 2016 to compute taxable income under the head 'Income from Business or Profession' and 'Income from Other Sources'. To overcome judicial rulings conflicting with the provisions of ICDS, the Finance Act, 2018 had made amendments/ introduced sections with retrospective effect from Assessment Year 2017-18. The said standards are mandatory and failure to adhere to the same could lead to adverse consequences. The said amendments are intended to nullify the ruling of the Hon'ble Delhi High Court in case of Chamber of Tax Consultants and UOI, rendered on the validity of Income Computation and Disclosure Standards (ICDS) notified by the Central Board of Direct Taxes.

Key amendments are as follows:

- Allowance of marked-to-market loss or other expected loss.
- Valuation of inventory at cost or net realisable value (NRV).
- Section 43AA inserted in the Act to provide that gain or loss arising due to changes in foreign currency rates is to be treated as income or loss.



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 Section 145B inserted to tax the export incentives as income of the previous year in which reasonable certainty of its realisation is achieved.

Further, it has been clarified that ICDS apply for income computation and not for maintenance of books of account. Further, ICDS are not applicable for computation of MAT.

Minimum Alternate Tax (MAT) on foreign companies – Section 115JB

The provisions of MAT are amended whereby it does not apply to a foreign company, if such foreign company is a resident of a country which:

- has a DTAA with India and such foreign company does not have a PE as defined in the relevant DTAA.
- does not have a DTAA with India and such foreign company is not required to seek registration under any law relating to companies.

This amendment is effective retrospectively from 1 April 2001 and applies to assessment year 2001-02 and subsequent years.

Minimum Alternate Tax (MAT) provisions to be aligned with IND-AS-Section 115IB

Pursuant to applicability of Indian Accounting Standards [Ind AS] to specified companies from financial year 2016-17, MAT provisions have been amended from assessment year 2017-18.

The broad framework for aligning Ind-AS compliant financial statements with MAT is as under:

- Net profits before other comprehensive income [OCI] to be considered as the broad starting point for MAT.
- Normal adjustments in computation of MAT as prescribed to be done.
- Prescribed adjustments to be made in relation to demergers.

- OCI items that will be permanently recorded in reserves (i.e. never be reclassified to statement of profit and loss) to be included in book profits for MAT.
- Adjustments on account of transitional provisions that are recorded in OCI and would subsequently be reclassified to the statement of profit and loss, would be included in book profits in the year of reclassification.
- Transitional adjustments recorded in Reserves and Surplus, excluding Capital Reserve and Securities Premium Reserve, (i.e. never be reclassified to statement of profit and loss) to be included in book profits for MAT.

GAAR provisions - Chapter X-A

GAAR is a set of provisions aimed at curtailing tax avoidance in general. It came in force from 1 April 2017. Tax avoidance is a deliberate measure to avoid or reduce tax burden by an individual or a company.

GAAR tries to examine imposition of taxes on those types of arrangements that are primarily aimed to avail a tax benefit or those which do not have any commercial substance.

Under GAAR, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement with attendant tax consequences. An arrangement would be declared as an impermissible avoidance arrangement if the main purpose or one of the purposes is to obtain a tax benefit and if the arrangement satisfies certain other conditions (lacks commercial substance, etc.)

The central government has notified rules (10U to 10UC) for application of GAAR.

As per said rules the GAAR provisions would not be applicable to an arrangement where the tax benefit does not exceed INR 3 crores. Further, investment made before 1 April 2017 are grandfathered.



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Deemed dividend - Section 2(22)

Prior to the amendment, the term "accumulated profit" for the purpose of dividend under section 2(22) meant profit of the company up to the date of distribution or payment or liquidation, subject to certain conditions.

The definition of "accumulated profit" is now expanded vide insertion of Explanation 2A, to include in case of amalgamation, the accumulated profits, whether capitalised or not, of the amalgamating company on the date of amalgamation.

Provisions of section 2(22)(e) of the Act have been made applicable to the company instead of the individuals, to prevent camouflaging of dividend by way of loans and advances. Accordingly, a company is required to pay DDT at the rate of 30% (without grossing up) under section 115-O on deemed dividend.

Penalty provision – Section 270A and Section 270AA

Finance Act 2016 has introduced a new mechanism for penalty in the form of Section 270A and 270AA replacing the existing provision of section 271(1)(c) of the Act. These provisions shall become applicable for assessments related with A.Y. 2017-18 onwards.

New section uses expressions 'underreporting and misreporting of income' instead of the old expression 'concealed the particulars of his income or furnished inaccurate particulars of such income'. Penalty shall be levied at 50% of tax payable in case of under-reported income and 200% of tax payable of the underreported income in case of misreporting.

Section 270AA provides for immunity from the levy of penalty. Under the said provisions assessee can make an application to the assessing officer to grant immunity from the levy of penalty

in case of under reporting of income, provided that tax due along with interest as determined as per the assessment order u/s 143(3) or 147 is paid, and no appeal is preferred against the assessment order. The assessing officer shall pass an order accepting or rejecting application made for immunity from penalty.

Revised safe harbour rules

The Central Board of Direct Taxes ("CBDT") introduced the revised Safe Harbour Rules ("SHR") on 7 June, 2017. While the revised rules primarily bought a revision to the existing safe harbour rates for the eligible international transactions along with limiting the applicability of SHR by revising the monetary threshold, the revised SHR also included new transactions like the receipt of low value adding intra-group services within their ambit.

Secondary adjustment

The Indian Government introduced the concept of secondary adjustment in the Finance Act 2017 whereby taxpayers would need to make a corresponding secondary adjustment to their books of accounts to give effect to any primary adjustment made to their transfer prices. This provision will be applicable in cases where the primary adjustment is:

- Either suo moto made by the taxpayer himself.
- Made by the Assessing Officer and accepted by the taxpayer.
- Determined by way of advance pricing agreement/ Safe Harbour Rules/Mutual Agreement Procedure.

The secondary adjustment would be applicable to companies from the FY 2016-17 onwards. Where the excess money as a result of the secondary adjustment is not repatriated to India within 90 days, the same shall be deemed to be an advance to the AE and a notional interest on the same will be imputed.



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Introduction of Goods and Services Tax (GST) in India

Goods and Services Tax was introduced in India in 2017 after a major await since its ideation in 2006. The new framework was characterised by destination based consumption tax with dual GST between Centre and States. GST subsumed major indirect taxes including Central Excise Duty, Service Tax, Value Added Tax, Central Sales Tax and various Cess. The taxable event under each indirect tax was consolidated into a single concept of "supply" for levy of GST.

The law also brought a paradigm shift into devising location of supplier and location of recipient for both goods and services thereby creating State wise recognition of businesses and corresponding registration and compliance requirements. With the additional compliance requirements, the law also brought in synergies with respect to availment of Input Tax Credits for major business models.

In the context of TMT industry, some of the major impact areas from GST include the following:

- Multiple registrations to be obtained in each state of operation.
- Multiple returns to be filed for each GSTIN on a monthly basis.
- Exports to continue to be zero-rated with a liberalised option to claim refund within 2 years from exports.
- Seamless credits of many ineligible procurements from previous indirect tax regime.
- Credit of GST paid on goods available to service providers and that paid on services available to traders in goods.
- Dual taxes of VAT and Service Tax on transactions such as copyrights, AMC contracts, IPR, software, print media replaced by GST.
- Dual taxes of service tax and entertainment tax on Value Added Services replaced by GST.

- Need for cross-charging supplies between Head Office and branches.
- Specific status and place of supply rules for OIDAR services, e-commerce operators, telecommunication service providers.

The benefits that have arisen from GST has boosted the overall status of TMT space since the industry is characterised by significant imports owing to technological procurements and equally significant exports in terms of services and product development by everexpanding research and development facilities in India.

Evaluation of taxation on Online Information Database and Access Retrieval (OIDAR) services

Under Indirect Tax provisions, it is relevant to note that prior to 1 December, 2016, OIDAR services provided by nonresidents were not liable to tax in India, since place of provision of service was the location of service provider. However, effective 1 December 2016, the provision were amended and the place of provision of OIDAR service was prescribed as the location of service recipient. This was a major shift in the taxation of digital supplies aligning the tax provisions to OECD guidelines to curb tax evasions. Further, the purview of OIDAR services was expanded to cover services that were delivered over internet which were automated and involved minimal human intervention and to also include electronic services in various forms. This was also a significant amendment considering the traditional concept of OIDAR services which were merely restricted to database access and retrieval services over internet vis-à-vis all types of services which could be rendered over internet e.g. supply of software, e-learning training, website related hosting and maintenance services, cloud services, advertising over internet, digital data storage, online gaming etc., which were hitherto covered under specific services.



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In parallel, there were significant amendments made in OIDAR whereby the supplies were classified into two categories as B2B and B2C supplies. In case of cross-border B2B transactions, service recipient was required to pay taxes under reverse charge and in case of cross-border B2C transactions, which were earlier exempted (prior to December 2016) were made taxable and liability to pay tax was shifted on non-resident service provider. Further, if intermediary located outside India facilitates OIDAR services then such person is liable for registration and payment of taxes in case of B2C services. In GST, the provisions on taxability remain same and there are no major changes.

This has mandated the non-resident OIDAR service providers making B2C supplies to register in India and undertake compliances under service tax. In GST regime, OIDAR service provider located outside India, would have to obtain single registration with central jurisdiction located in Karnataka.



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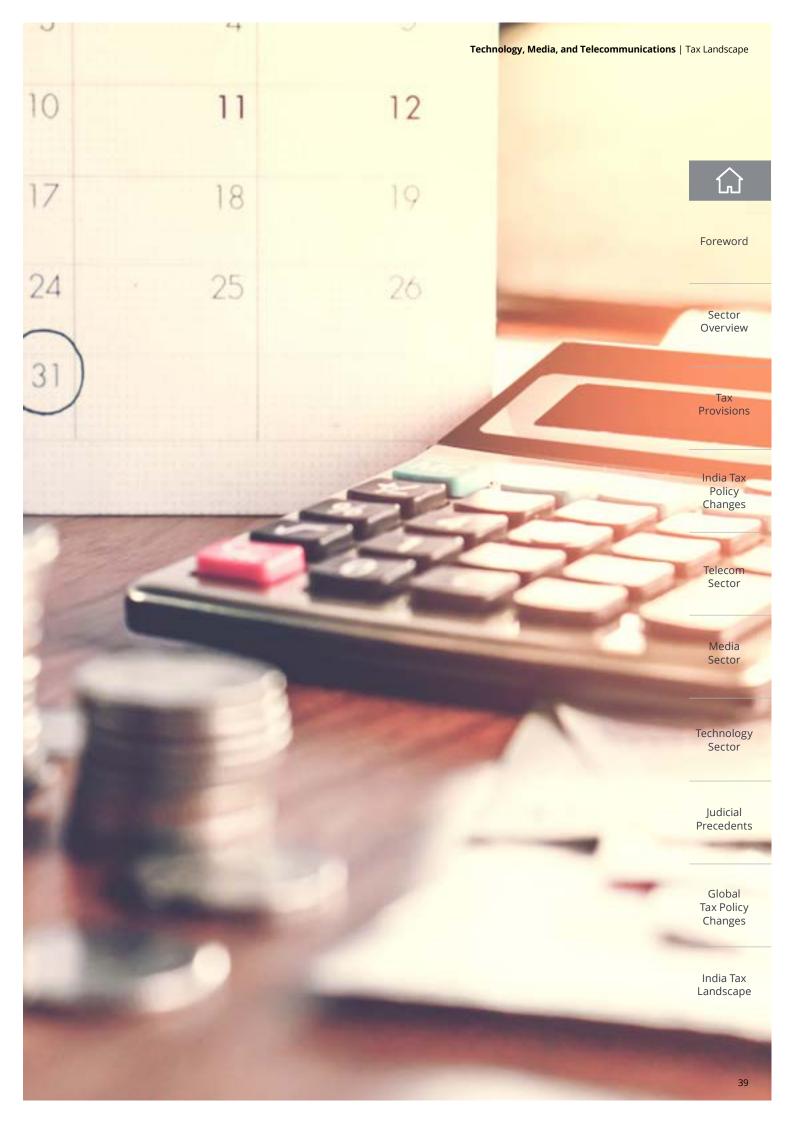
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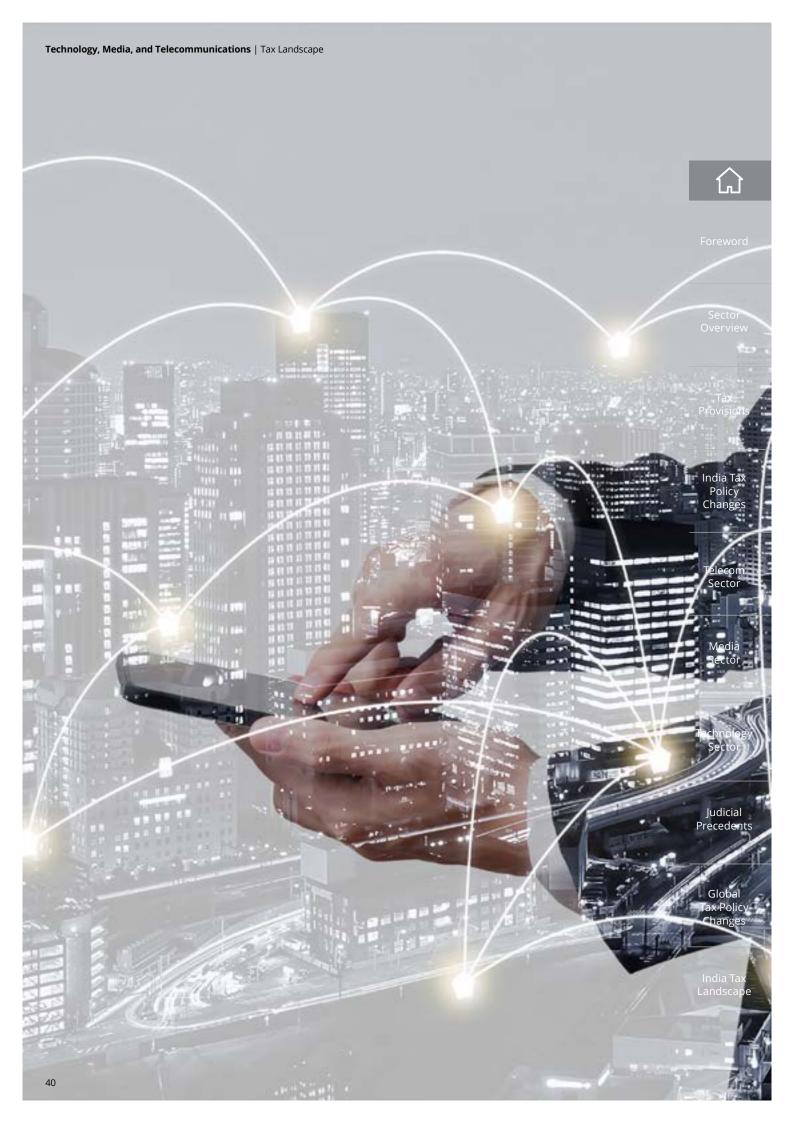
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Telecommunications sector: Key tax considerations

"Telecommunications" is a technology of communicating by electronic transmission of impulses at a distance. The telecommunications sector in India is the world's second-largest telecommunication market. Fixed line telephony is almost a feature of the past, though not extinct. Cellular telephony is the fastest growing segment in the Indian telecommunications industry. Telecommunications operators are at a turning point in the evolution of their industry. Three major trends being demand for ubiquitous connectivity, rise of modular technologies, and increasing competition within and outside the industry are transforming the manner in which telecommunications players are creating value. In order to survive, operators are forced to revamp their business models to take advantage of new opportunities in a hypercompetitive sector of the Indian economic sector. The telecommunications industry has helped to fuel the digital transformation across the socio-economic strata-increasing demand for smartphones and availability of high speed networks, such as VoLTE and 4G, has changed the dynamics of

to players involved in the business. Tariff reduction, reasonably varied value added services and decline in handset and other ancillary telecommunications equipment costs have opened new vistas of operation across the telecommunications sector. Since there is a fair penetration by foreign players into the Indian telecommunications market across various business segments, the ensuing paras attempt to bring out some of the income tax aspects for nonresident enterprises operating in the telecommunications sector. This aspect is also pertinent from the perspective of onerous withholding tax obligations in India by the payers of income.

The telecommunications sector in India added around 230 million subscribers since 2014, making it the 2nd largest telecommunications market in the world.¹ The broadband services witnessed significant growth in the subscriber base with almost 380 million new subscribers in the same period due to commercial launch of pan India 4G services, falling data tariff and availability of affordable smartphones in the market.² India is currently the fastest growing app market and largest consumer of internet data in the world.³

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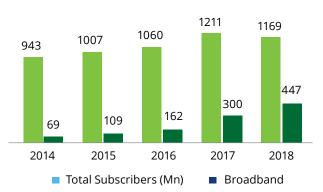
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India Tax Landscape

Total Subscribers and Broadband Subscribers Trend

Indian telecommunications market.

besides offering immense opportunities



Fastest growing application market in the world and largest consumer of internet data

2nd India is the second largest telecommunications market and internet market in the world

79.72 Million 3G 105.83

Million

238.34

Source: TRAI

Supply of equipment/mobile handsets

The companies operating in the business of supplying equipment, which are used for setting up the infrastructure for telecommunication, may be classified into two broad categories:

a. Supply of equipment without any software

Many telecommunication equipment are imported from outside India for setting up a strong infrastructure in India. Such equipment if imported from outside India and the delivery of which is also taken out of India, may not result into any tax implications in India. However, if the equipment are delivered in India or within the Indian territorial waters then the income from such sale will be taxable in India. Income of a non-resident will be taxable in India if it is received/ deemed to be received in India or accrues or arises/ deemed to accrue or arise in India. An income is said to be deemed to accrue or arise in India if the same is accruing or arising directly or indirectly, through a business connection in India.

b. Supply of equipment along with embedded software

Many of the equipment are imported along with the software and such software is an integral part of the equipment purchased. Since in India, the law on software taxation is yet not settled, in the scenarios involving embedded software, one of the frequently encountered issues is whether software embedded into the equipment supplied could be liable to tax in India as "royalty".

Purchase of equipment with embedded software cannot be segregated into purchase of equipment and software separately. The software being inbuilt in the equipment, is an integral part of the same. The predominant purpose of the purchaser is the purchase of equipment and not the software

embedded in it. The consideration is paid towards purchase of equipment, of which software is an inseparable part and incapable of independent use and the same shall be regarded as being towards supply of goods. Consequently, no part of the payment can be classified as "royalty".

However, where the software and hardware are purchased separately and thereafter integrated by the company and the integrated product is sold then in such a case, the software purchased by the company shall be taxable as royalty under the ITA as the purchase of software is independent of hardware.

Taxability under the relevant tax treaty

Based on the above-mentioned, it may be well arguable that sale of equipment along with embedded software cannot

Article 12 of the OECD Model Convention defines the term 'royalty' as follows:

"Payment of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

Article 12 of the UN Model Convention defines royalty as follows:

"Payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience."



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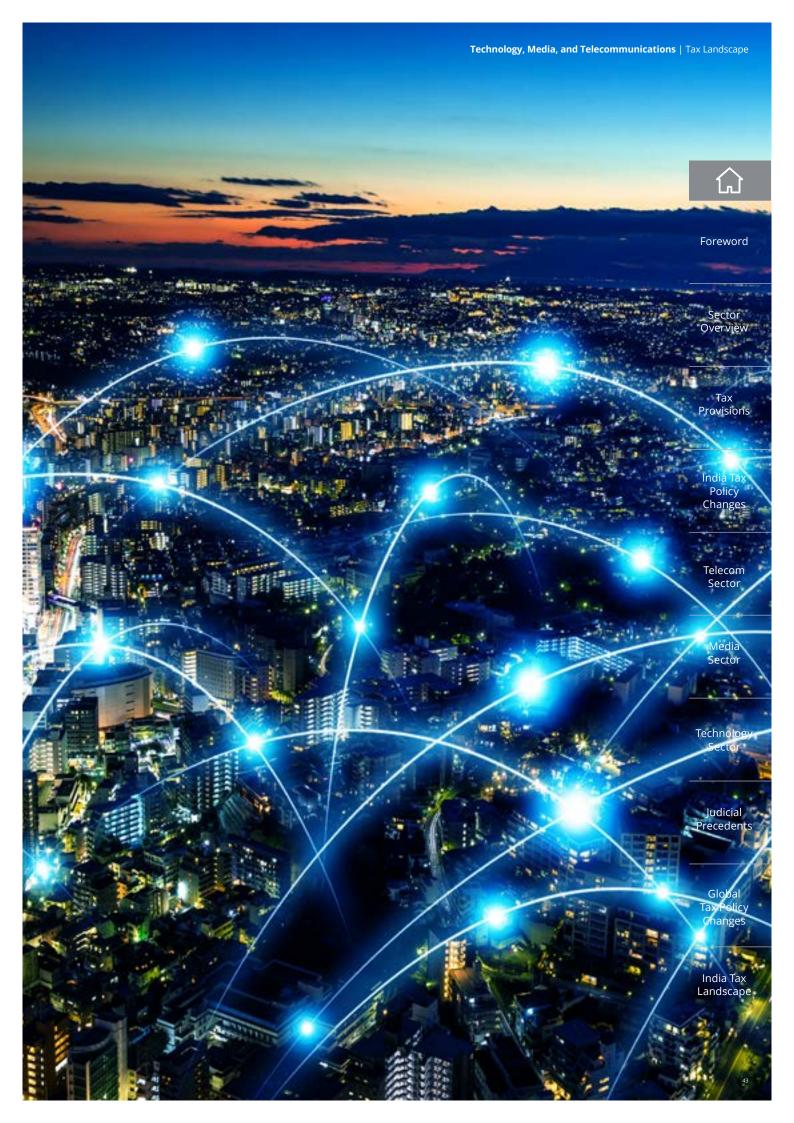
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be classified as use or right to use of a copyright (i.e. to exploit the rights that will otherwise be the sole prerogative of the copyright holder) but a sale of a copyrighted article protected under the Copyright Act, 1957. Accordingly, since the purchaser of the equipment do not have a right to exploit the software but only to use it for the purpose of its business in the same form as it is provided, it can be argued that the sale of equipment along with embedded software does not result into royalty under the Tax Treaty as well.

Services availed from telecommunications infrastructure service providers

Telecommunications infrastructure companies facilitate telecommunications services through provision of infrastructure support services to mainstream telecommunications service providers, such as providing access to common towers, continuous power supply, air-conditioning, etc. Since these services are not specifically covered under any substantive or withholding tax provisions, payments towards these services are prone to litigation on the aspect of withholding tax compliances. One may seek to align the payments for the telecommunications infrastructure services as a subject of taxation basis discussions above and below but it will be helpful to receive precise clarity on this count, under law.

Connectivity charges paid to telecommunications operators

The connectivity/airtime charges paid to telecommunications operators are essentially for the voice and data services. Voice services denote call transmission services and comprise of call termination and interconnection services and roaming services. Data services denote data transmission services and comprise of VPN, IPLC and Internet services. The customers make payment for such charges to the domestic telecommunications operator. All forms of data services involve transmission of data through optic fibre cables or satellites or undersea cables and thereby entail payment of bandwidth charges.

Herein relation to the connectivity charges, an issue arises regarding the India taxation of connectivity charges paid to telecommunications operators.

When the customer uses international network for making calls outside India or the roaming facility or transmission of data then in such cases the Indian telecommunications operator will charge the customer for the long-distance charges. The Indian telecommunications operators will in turn, pursuant to agreements with international telecommunications operators for using its network, be obligated to pay consideration to such foreign operators for network connectivity. Certain tax issues associated with these network arrangements are discussed as follows:

a. Connectivity charges paid to domestic telecommunications operators

There has been a debate about whether consideration paid by the customers towards airtime charges will constitute fees for technical services and thus, subject to withholding tax under section 194J of the ITA. Another issue for consideration before the courts has been whether national roaming charges could be regarded as rent for "use of equipment" for the purpose of withholding tax under section 194I of the Act.

The courts have held that the usage of technology for providing services such as roaming facility or transmission of data does not become technical services and thereby airtime charges and call charges raised by the telecommunications companies cannot be subject to any tax deduction at source under the provisions of the ITA. Further, courts have also decided that the payment of roaming charges for use of the visited network cannot be regarded as consideration for the use of equipment and will thus, not be subject to any withholding tax.



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Connectivity charges paid to foreign telecommunications operators

Payments towards connectivity charges to foreign telecommunications operators are subject matters of debate based on whether they are payments for technical services, thereby fees for technical services (FTS) or towards usage of secret process or formula, thereby royalty.

Fees for technical services under the ITA as well as tax treaty

Based on the various judicial precedents, following view arises on taxability of Connectivity charges paid to foreign telecommunications operators:-

- Air charges⁴ paid to telecommunications operators are not in the nature of managerial, consultancy or technical services and therefore, cannot be regarded as fees for technical services under the ITA.
- Services such as roaming, long distance calls, and data transmission will not be taxable as FTS⁵.
- Voice charges⁶ are in nature of service charges and not managerial, consultancy or technical services i.e. FTS and in absence of PE, income shall not be taxable in India.
- Payment for telecommunications facility such as downlink data⁷ through customer based circuits provided by foreign telecommunications companies outside India could not be treated as fees for technical services or royalty under the ITA or the India-US tax treaty.
- Payments for use of bandwidth⁸
 provided for downlinking signals
 are not in the nature of managerial,
 consultancy or technical services
 nor is it for the use of or right to use
 industrial, commercial or scientific
 equipment. The payments made for

bandwidth are akin to the payment made for use of mobile phone services.

• Payments for inter-connection usage charges is neither FTS nor royalty under the ITA as well as the relevant tax treaty⁹. It is a standard facility and does not involve any technical services. The process to run such facility is a general one available on public domain and not an exclusive one. Thus, it cannot constitute be characterised as royalty.

Thus, based on the above, it can be inferred that consideration paid to a foreign telecommunications operator towards air charges, roaming charges, etc. will not be taxable as fees for technical services both under the ITA as well as Tax Treaty.

However, whether such consideration could be taxed as "royalty" needs to be analysed especially, after the retrospective amendments made to section 9(1) (vi) of the ITA by Finance Act 2012.

Royalty under the ITA

As per Explanation 2 to section 9(1) (vi) of the ITA, 'royalty' interalia includes consideration for the use of any patent, invention model, design, secret formula or process or trademark or similar property or for use or right to use any industrial, commercial or scientific equipment.

The issue is whether payment towards interconnectivity charges will qualify as use of equipment or process and thus, be classified as royalty.

With the insertion of Explanation 5 & 6 to section 9(1) (vi) of the ITA, it is clarified that 'royalty' includes and has always included consideration in respect of any right, property or



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information whether or not the possession or control of such right, property or information is with the payer or whether the same is used directly by the payer or whether the location of such right, property or information is in India. Also, it has been clarified that the expression 'process' includes and shall deem to have always included transmission by satellite (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 light of the above, will payment for roaming charges be considered as a use of process or use of equipment for transmission by satellite? The process of international roaming facility includes transmitting signals from home network to international network, which will enable transmission of voice, messages, and data from one country to another. This entire act of transmitting signals is a process for facilitating communication. Thus, consideration paid by the Indian telecommunications operator towards such process or use of transmission equipment to the international telecommunications operator can be classified as 'royalty' under section 9(1) (vi) of the ITA especially in light of the amendment by Finance Act 2012 through insertion of Explanation 6 wherein it is no longer necessary to determine whether the process is secret or not. However, AAR in the ruling of **Dell** International Services India (P.) Ltd., In re [2009] 305 ITR 37 (AAR) held that by availing facility provided by foreign company through its network/ circuits, there is no usage of equipment by the assessee. It is a case of the foreign company utilising its own network and providing a service that enables the assessee to

transmit voice and data through

telecommunications bandwidth and,

therefore, payment made by assessee to foreign company cannot be taxed as 'royalty' under Explanation 2 to clause (vi) of section 9(1) or under article 12 of Treaty. In the light of the amendment, by way of insertion of Explanations 5 & 6 to section 9(1) (vi), the consideration paid towards roaming charges, transponder charges, etc. could be classified as 'royalty' under the ITA. However, the taxpayer can rely on the AAR ruling as regards the taxability of use of equipment for transmitting voice/data.

Royalty under the Tax Treaty

Article 12 of the OECD Model Convention defines royalty as "payments of any kind received as a consideration for the use of, or the right to use, any copyright or literary, artistic, or scientific work, including any patent, trademark, design or model, plan, secret formula or process, or for information..."

The Finance Act 2012 has made amendments to section 9(1) (vi) of the ITA to bring the connectivity charges within tax ambit. However, whether such amendments will have any impact on the taxability of royalty under the ITA needs to be analysed.

Under the ITA, post the clarificatory amendment to section 9(1)(vi) vide insertion of Explanation 6 it is clear that process includes all process and not just secret process. However, in the context of the tax treaty, a view is that process shall cover within its ambit only secret process.

Here reference is drawn to the OECD Commentary on Model Convention 2010 wherein it is categorically mentioned that payments made under a typical roaming agreement will not constitute royalty since these payments are not made in consideration for the use of, or right to use, property or for information as they cannot be viewed as



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payments for the use of, or right to use, a secret process since no secret technology is used or transferred to the operator.

Thus, under the tax treaty, payments made to foreign telecommunications operators towards roaming charges shall not constitute royalty as per Article 12 of the tax treaty.

As regards insertion of Explanation 6 to section 9(1)(vi) of the ITA, the issue is whether the same will have any impact on the tax treaty as well. The Mumbai Tribunal in the decision of B4U International Holdings Ltd.10 has examined the taxability of transponder hire charges paid to a foreign entity in India. The Tribunal placed reliance on the Delhi High Court decision of Asia Satellite Communications Co. Ltd. and held that payment cannot be regarded as royalty under the India-USA Tax treaty. The Tribunal also held that the amendments to the definition of 'royalty' under the ITA will not have any impact on its decision, as there is no change in the India-USA tax treaty to the definition of royalty.

Further, the Delhi High Court in the decision of New Skies Satellite BV¹¹ has held that insertion of Explanations 4, 5 and 6 to section 9(1)(vi) by Finance Act 2012 by itself would not affect the meaning of the term 'royalties' as mentioned in article 12 of India-Thailand DTAA unless the tax treaty is amended jointly by both parties to incorporate the said income in the definition of royalty. However, the Supreme Court¹² has granted an SLP against the said High Court ruling.

Further, where such amounts were intended to be taxed as royalty, the same have been specifically included in the definition of 'royalty' under the tax treaty e.g. the definition of royalty under the India-Hungary tax treaty specifically includes payment

towards use of, or right to use transmission by satellite, cable optic fibre or similar technology. The Protocol to the India-Mexico tax treaty has clarified that the term "royalty" would be deemed to include payment of any kind received as consideration for the reception of the right to receive visual images or sounds, or both for the purpose of transmission by satellite, cable optic fibre or similar technology.

However, the Madras High Court in the case of Verizon Communications Singapore Pte. Ltd¹³ has taken a view that the consideration received by the non-resident taxpayer from the Indian customers for provision of bandwidth/telecommunications services outside India was for the 'use of, or the right to use equipment' and therefore, royalty under section 9(1) (vi) of the ITA. Alternatively, the payments can also be considered for the use of process provided by the taxpayer and therefore, royalty under the ITA. The High Court further held that the definition of 'royalty' under the India-Singapore tax treaty and the ITA are in pari-materia and therefore, the consideration will be royalty under Article 12(3) of the tax treaty.

The above discussion aims to highlight the controversy behind the taxability of connectivity charges. It may be further noted that India has not agreed with the interpretation of the OECD member countries as regards Article 12 relating to roaming charges and has stated that roaming call constitutes the use of process. Accordingly, the payment made for use of that process constitutes a royalty for the purposes of Article 12. In addition, India's position is that payment for roaming call constitutes a royalty since it is a payment for the use of industrial, commercial or scientific



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equipment. Further, in view of the previously mentioned ruling of the Madras High Court in the case of Verizon, the Revenue may tax bandwidth charges taxable as royalty under both the ITA as well as the tax treaty.

While there has been a fair certainty about the requirement of human intervention in a service for treating such service as a technical service post the Supreme Court ruling in case of Bharti Cellular, the recent AAR ruling in case of MasterCard Asia Pacific Pte Limited where it held that even an automatic equipment being a payment processor can constitute permanent establishment for the foreign company in India appears to taint the above principle of human involvement in course of technical service. Although, it shall be interesting to watch whether Higher Courts reverse the AAR decision eventually, albeit in the different context being PE, it is also important to sense the dynamics of interpretation of tax law while dealing with automated processes.

Spectrum fees

The Government of India, through the Department of Telecommunications ('DoT'), has allotted the rights to use spectrum in various telecommunications service areas in India by means of an auction. To ensure a successful auction and a healthy business for operators, DOT has stated that the Government is evaluating the proposal of allowing treatment of upfront auction price as a capital asset for the purpose of tax depreciation. There was a need to bring out specific amendment to Section 32 and Appendix I to the IT Rules to clarify that the spectrum fee payment qualifies as "Intangible asset", since substantial investments are involved towards spectrum allocation. Accordingly, the telecommunications operators who have paid 3G spectrum fees for availing the rights can claim the deduction through depreciation.

The Finance Act, 2016 introduced Section 35ABA with effect from April 1, 2016 to provide for amortisation of expenditure incurred for acquisition of 'right to use spectrum' over the tenure of the right. With the introduction of section 35ABA, tax position as regards acquisition of 'right to use spectrum' stands settled post April 1, 2016. However, ambiguity on taxation of these payments made prior to April 1, 2016 is still open, i.e., whether the consideration shall be amortised under section 35ABB (which provides for amortisation of payments made only towards acquisition of a 'telecommunications license') or eligible for tax depreciation under section 32 of the ITA.

Payments for international connectivity through use of submarine cable systems

A submarine communications cable is a cable laid on the seabed between land-based stations to carry telecommunication signals across stretches of ocean. Modern cables use optical fibre technology to carry digital data, which includes telephone, internet and private data traffic. The set-up of the submarine cable under ocean across the world will be a very costly affair. Therefore, the trend followed under such business is to create a consortium to jointly lay down such infrastructure.

Generally, the telecommunications company located in that particular country owns the submarine cable system located in a particular country. The capacity is allocated to the consortium parties which is accordingly, used by the respective owners for providing connectivity services. The Indian telecommunications operators may enter into an arrangement with foreign submarine cable owners for providing capacity. This generally involves exclusive right to the Indian telecommunications operator to use allocated cable capacity for a particular time. The key issue is whether consideration paid to the foreign companies for providing capacity in



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a submarine cable system to Indian telecommunications companies for international connectivity shall be taxable as capital gains under section 45 of the ITA or shall be in the nature of royalty.

The amount received on grant of right to use for a long tenure can be regarded as transfer of interest in an asset and could be taxable as capital gains under section 45 of the ITA. However, attention is invited to the AAR ruling in the case of Dishnet Wireless Limited¹⁴. The Applicant, an Indian company engaged in the business of providing telecommunication services in India, entered into an agreement with a Saudi Arabian Company for transfer of the right to use the capacity in the EIG cable system (Europe India Gateway submarine cable linking Indian subcontinent and the United Kingdom) for a consideration of USD 20 million.

The applicant contended, inter alia, that, as the amounts payable to the foreign company represented payment made for acquiring a 'capital asset' which was entirely situated outside India, such payment could not be taxed in India both under the ITA and under the India-Saudi Arabia tax treaty.

The issue for consideration before the AAR was whether the payment made by the Applicant to the foreign company for acquisition of the cable capacity will be chargeable to tax in India.

The AAR held as follows:

- No right of ownership, property in or title to the capacity, facilities or network infrastructure, equipment or software was conveyed to or vested in the Applicant. Transfer of a capital asset is different from transfer of a right to use exclusively a part of the system and hence, the consideration paid to the foreign entity cannot be considered as capital gains.
- The transfer of capacity by the foreign company to the applicant amounted to

- 'making available' the right to use the capacity in the EIG cable system.
- In view of the clarificatory amendment in Section 9(1)(vi) of the ITA, the payments made by the applicant to the foreign company for the acquisition of cable capacity were for a right to use a process and a right to use commercial or scientific equipment and will therefore be taxable in India as "royalty".

However, the AAR did not comment as to whether the consideration will be taxable as royalty under the tax treaty as well. Accordingly, the issue remains debatable as to whether the consideration paid for the right to use the capacity will be taxable in India under the tax treaty.

Another issue, which may arise, is whether the submarine cable laid in India can constitute a PE of the foreign entity in India. Article 5 of the tax treaty states that an entity shall constitute a PE in India if it has a fixed place through which it carries out its business in India. Reference is drawn to paragraph 10 of the 2010 OECD Commentary on Article 5, which states that whether or not gaming and vending machines set up by an enterprise in other State constitutes a PE, depends on whether the enterprise carries on business through such machines after the initial setup. A PE does not exist if the enterprise merely sets up the machines and leases the same to other enterprises. A PE may exist, if the enterprise sets up the machines and also operates and maintains them for its own account.

Applying the aforesaid ruling, it could be stated that in case submarine cable is automatic equipment, and if the foreign telecommunications company operates and maintains the submarine cables for its own account, then it may constitute a PE of the foreign entity in India. Accordingly, if the foreign entity is said to have a PE in India then profits attributable to the part of cable situated in India will



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be taxable in India on net basis. However, if the foreign entity leases out a part of the submarine cable to another entity, then a position can be taken that the foreign entity is not carrying out business through the submarine cable in India and accordingly, there may not be any permanent establishment of the foreign entity in India.

Withholding on sale of SIM cards and discount vouchers

The telecommunications operators appoint independent distributors to sell telecommunications vouchers to the end users through retailers. These distributors are appointed on a principal-to-principal basis to sell the vouchers to the retailers.

Based on various court rulings¹⁵, one view is that sale of SIM cards/ recharge coupons at discounted rate to distributors is not commission and therefore not liable to TDS u/s.194H of the ITA.

The above view is on the basis that the discount allowed to the distributors is on principal-to-principal basis and not that of principal to agent. It is also important to note that in such arrangement, the transaction in all substantial respects is akin to sale and purchase of goods as it happens in FMCG sector.

However, there is a contrary view in this regard supported by various Court rulings¹⁶ which has held that relationship between assessee and its distributors (for SIM & recharge coupons) was that of principal and agent and, consequently, amount of discount offered by the cellular company to its distributors was in nature of commission liable to tax deduction at source under section 194H.

From an indirect tax perspective the industry witnessed a transformation on various areas owing to introduction of GST. Further, there still remain certain burning issues which warrant redressal from the government.

Transfer of an indefeasible right to use

The companies owning fibre network or a communications cable generally seek to sell the excess network capacity to another telecommunications operators. This is in order to minimise the maintenance cost and optimise resources. This arrangement is referred to as an IRU agreement in the business parlance. An IRU is a contractual agreement that confers an indefeasible right of access to equipment, fibres or network capacity on to another telecommunications operator for an agreed period, in return for upfront or recurring payments. Such right is transferred on an exclusive basis. This again led to an ambiguity in respect of the treatment of IRU, as sale of goods or provisioning of service. While leasing an equipment is generally is in the nature of service, the same may be treated as deemed sale of goods, if it involves transfer of right to use the goods. Hence leading to double taxation. This anomaly has been put to rest with the introduction of GST, with the Central and the State Government both getting their share of revenue. In GST transfer of right to use is considered as supply of service and supplier is liable to pay Central Tax and State Tax in case of intra-state supply or Integrated Tax in case of inter-state supply. Discontinuation of the dispute has the potential to optimal sharing of equipment and other resources, which shall prove fruitful to the sector.

Cessation of dual taxation on value added services provided by a telecommunications operator

The value added services such as online storage, music subscriptions, mobile gaming and apps etc. provided by the telco attracted levy of entertainment tax as well as Service Tax. This led to dual taxation which dampened the supply as it led to increased cost in the hands of the consumer. With GST implemented, the Entertainment Tax as well as Service Tax are subsumed, which would reduce the final cost to be incurred by the



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consumer for availing these value added services. The consumers are the ultimate beneficiary in this matter, which will eventually boost the digital economy.

ITC on telecommunications towers

The telecommunications have been engaged in protracted litigation on the question of eligibility of Input Tax Credit (ITC) of the indirect tax incurred on setting up towers, shelters or parts thereof. The Jaipur bench of the Tribunal³ has held that Towers and shelters and their parts are immovable property and therefore CENVAT Credit on the same is not allowed. In a similar case pronounced by the Bombay High Court held that duty paid on towers (in CKD/SKD form), parts of towers, shelters are neither capital goods nor inputs as defined under CENVAT Credit Rules. Also in the said case, it was held that in any event the towers and parts thereof are in the nature of immovable property and are non-marketable and non-excisable, they cannot be considered as inputs.

The guestion has remained unanswered or ambiguous even in the GST regime and revolves around whether the telecommunications tower would be considered as an immovable property. The ITC in respect of goods and services received for construction of an immovable property (other than plant and machinery) is not allowed under GST. It would thus be a fair interpretation to say that goods and services used for construction of immovable property in the nature of plant and machinery is permissible under GST. However, the telecommunication towers have been specifically excluded from the definition of plant and machinery. A rational interpretation would imply that ITC in respect of goods and services used for construction of telecommunication tower would not be eligible. However, in absence of any specific definition of the term immovable property under the GST law, it is likely that the dispute shall continue. This could add to the misery of the sector already grappling with immense competition. The investment

that goes into a construction of tower is significant for a telco, which makes the ITC even more important from cash flow perspective. The eligibility dispute and the litigation costs involved could still continue to haunt the telco, which needs to be addressed on priority to provide a fillip to the already beleaguered sector.

Alignment of telecommunications circles with states

The telecommunications particularly the cellular telecommunications industry inherently functions in accordance with the license granted to it by the Department of Telecommunications (DoT). The DoT for the purpose of its operations constituted different telecommunications circles according to states or regions and the telecommunications licences are granted for specified circles. Based on the license granted by DoT, the telecommunications service provider would set-up infrastructure throughout the circle to enable connectivity/communication services to the subscribers. These telecommunications circles may not necessarily cover a particular State. For instance, the circle covering State of Maharashtra (except Mumbai metro area) also covers the State of Goa. Consequently, there are spills between the states within a given circle. Since the telecommunication service provider operates within a Circle, the revenue is recognised and the infrastructure is set-up at a Circle level (which may cover more than one State). The GST law demands that the revenue and expenditure (capex or opex) are each recognised at a state level. This not only leads to operational challenges, but also surges the compliance burden. It is very crucial for this sector to align the Circles with the state so that GST provisions can be complied with. This exercise would be a colossal task for the sector, as it would involve restructuring the revenue as well as the costs. Inter-branch supplies for infrastructure shared within the same Circle would also be required. In GST, transfer of goods by one branch to another or sharing of cost incurred



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at HO is considered as "Supply". The same will affect the cash flow of telco and would also increase the compliance burden. The non-alignment of the telecommunications circles and the states shall not only call for operational challenges, but will also significantly impact the accounting mechanism. It is desired that the government carves out an exception for the telco to let them obtain registration at a centralised level so that the regulation by the Ministry and the assessment by the GST authorities are synchronised.

Blocked ITC for telecommunications sector

The GST law does not permit any entity to obtain a centralised registration presently and therefore it mandates, or rather permits the supplier to take registration in only the state from where goods or services are supplied. The law does not require a person to obtain registration in the states from where no supply is being made.

In case where supplier doesn't have registration but has received a supply from the vendor who has charged Central Tax and State tax on said supply, the ITC of the same cannot be availed. This challenge could be explained by way of an example. For instance a person engaged in provisioning internet connectivity has Point of presence in Maharashtra, Delhi, Karnataka and Tamil Nadu. The customer base of the service provider is spread across the country. In order to provide connectivity services to a customer located in Gujarat, the telco may be required to receive leased circuit services in Gujarat. The providers of leased circuit services may be registered pan-India and the place of supply shall also be the location where the circuits are installed for receipt of services. The leased circuit providers would thus charge a local tax i.e. Central Tax and State Tax determining the place of supply as Gujarat. Since the service provider does not make any supply from the State of Gujarat, it would not have obtained

registration for the State and thus, end up losing the ITC. A recent amendment in the place of supply provisions in case of leased circuit services states that the place of supply for leased circuit services shall be determined on the basis of the points in each State. For instance, a person seeking connectivity between Point A in Maharashtra and Point B in Delhi, for which the connectivity service provider would approach the leased circuit service provider. The leased circuit service provider shall split the invoice into two thereby, treating place of supply as Maharashtra as well as Delhi in equal proportions. This amendment though addresses the issues of the supplier of leased circuit services, the concerns of the recipient as discussed above, are far from over.

This defeats the purpose and the objective with which GST was introduced i.e. avoid cascading effect of taxes. The costs of the telco providing these services would increase by 18% due to non-eligibility of the ITC. This will have a huge impact on the business of the telco, which did not face such challenge prior to introduction of GST. Under the earlier regime, since these entities would have obtained centralised registration, there were entitled to ITC in respect of service received anywhere in the country. Since the telco are deprived of the ITC that is rightfully eligible to them, the cost of providing telecommunication services would increase substantially, with the consumers bearing the final brunt.

Telecommunications industry has always been at the forefront of technological evolution. With advanced talks around launch of 5G services on the backdrop of successful run of the 4G/VoLTE services, the momentous growth seems to be constant of the telecommunications industry. However, it may well be reiterated that these growth stories are frilled with regulatory hurdles and the tax laws also undergo changes to ensure commensurate impact based on industry steps.



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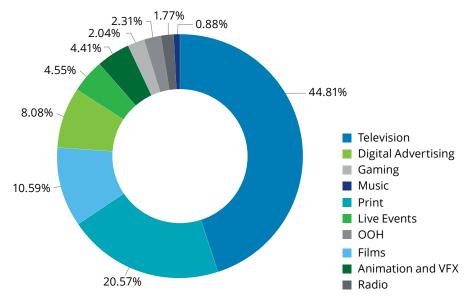


Media sector: Key tax considerations

The Indian media industry has been consistently growing in all the segments due to rising incomes and evolving lifestyles. While content and performances across the traditional media being print, radio, television, radio, music, sports and live events, has always reflected enhanced consumption by audience across demographics, the other forms of media in the form of filmed entertainment, out of home (OOH), animation and visual effect (VFX), online gaming, digital advertising, over-

the-top (OTT), video on demand (VoD), social media marketing, customisable chatbots, social media listening tools, etc. are trending well. As per publicly available research reports, the Indian Media and Entertainment (M&E) sector is expected to cross the USD 40 billion mark by 2021 by growing at compounded annual growth rate (CAGR) in excess of 12%. The sector shall continue to employ people and attract talent relevant to its various subsegments.

Size of Major Industry Segments



Source: Ibef

It's well known that existing tax laws was developed primarily towards a world of physical goods and in-person services. Today, entertainment content is increasingly provided digitally, with minimal human intervention, through computer servers instead of physical

distribution chains. The old rules don't always address what happens in newer, virtual business models. As a result, the framework for determining the tax treatment of income from online transactions requires tax directors to reframe the following basic questions:



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What type of transaction is it? The type of transaction affects the character of the income, which in turn affects how it is taxed. Online transactions that involve transfers of property rights (e.g., online downloads of movies) typically involve limited licenses that are treated for tax purposes as royalties, rentals or sales, depending on the extent of the rights conveyed. For e.g., rights to alter or broadcast code, and whether the rights are time-limited, need to be considered. Instead of involving transfers of property rights, other transactions might involve access to content or systems in the cloud that are more properly described as service transactions. Access to online games, music and news, for e.g., which are not downloaded, might be structured this way. Finally, transactions might have elements of both a property transfer and a service, such as downloaded games or other software.

The transition to new types of income streams could create exposures within historic tax structures. For e.g., companies licensing content through a foreign distribution structure historically may have had US tax deferral on royalty income. However, if the character of the income streams changes to services, different requirements to maintain deferral. In addition, revenue streams characterised as services may raise new local-country tax issues. Permanent establishment risks should be managed more closely in the context of services e.g., a permanent establishment. A change in the type of transaction and the entity earning income may also affect the withholding taxes levied.

In the past, audiences consumed pre-packaged content through a few distribution channels that were largely set by content owners and broadcasters according to preferred models. More and more, audiences want the ability to access content, manipulate it and share it through social media. This new paradigm involves remote consumption and use of content often stored in "the cloud," a method of computing that makes

resources such as storage, databases and applications available through the internet. For instance, in case of other than tangible property sales, there are two main ways of sourcing the latter: cost-of-performance and market base. The obvious guestion arises on allocation of income i.e. whether to allocate the income to the state where production costs are incurred or whether to allocate the income among the states according to the number of viewers. There is a prevailing view that income from digital delivery of software should be sourced in the same way as revenue from software in a shrink-wrapped box. Would the same view hold good for entertainment delivered digitally?

The next few paras attempt to touch upon some of the niche characteristics and tax issues relevant to the subsegments of the Indian media sector. Specifically it may be noted that tax issues arising on payments in the broadcasting sector are one of the most litigious in the recent times. Major tax controversies arise due to the nature of cross-border business operations in the broadcasting sector and charaterisation of payments as "Royalty" or otherwise. The government has also issued circulars to clarify TDS aspects in relation to payment to software production houses and advertising commission/discount given by broadcasters to advertising agencies but there still remains a lot of controversy over some other payments made by this industry. Another issue is restriction on carry forward of losses on amalgamation in case of M&E Industry.



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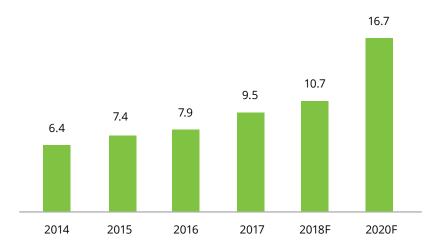
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Advertisement and Broadcasting

Advertising Revenue Forecast (USD billion)



Source: Ibef

This section briefly touches upon the tax aspects pertaining to provision of advertisement and broadcasting activity, including digital/print media advertisement, content development and transmission. Similar to the other sections of this publication, the focus for our analysis centres around non-resident players in the industry, since taxation of residents involve relatively less controversies due to inherent worldwide taxation concept. While the source of income is quite important in the context of non-resident taxation, the principal substantial law in this regard is around "royalty" as defined under explanation to section 9(1)(vi).

Section 9 is the deeming provision relating to the income of non-residents that are considered to have its source in India. Section 9 (1) (vi)(b) of the ITA deals with royalty paid by an Indian resident and received by a non-resident, and Explanation 2 thereto defines 'Royalty' as: "Explanation 2.—For the purposes of this clause, "royalty" means consideration for— i. the transfer of all or any rights in respect of a process;

ii. the imparting of any information concerning the working of a process; iii. The use of any...process; It may be important to note in this regard that, through a retrospective amendment to the ITA by the Finance Act, 2012 the expression "process", through Explanation 6 has been made to include transmission by satellite, including a uplinking, amplification or conversion for down linking of any signal. This explanation is significant owing to the fact that the term 'process' now explicitly includes the use of transponders for satellite communication. However, regardless of changes to the ITA, the definition of royalty under the DTAA remains unchanged and the provision beneficial to the assessee will apply. This position has been upheld by the Income Tax Appellate Tribunal in the case of B4U International Holdings Ltd. v. DCIT.

Under a broadcast arrangement, typically, three parties are involved for advertising arrangements on television channels, namely – broadcaster, advertising agency, and advertiser. Looked at from another perspective, the key constituents of



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a broadcasting arrangement are the content producers, the broadcasters, the cable operators (MSOs and LCOs) and the ultimate consumer/viewer. Payments are made by the advertiser to the advertising agency and by the advertising agency to the broadcaster. In the context of sporting events, typically the hosts of sporting events earn substantial

revenues through exploitation of various rights associated with such events. One of the key revenue sources is exploitation of live broadcasting rights.

In this backdrop, we have hereunder analysed each of the aspects as envisaged in the definition of royalty visà-vis taxability for a foreign broadcaster:

has been sold or given on hire on

iii. To communicate the film to the

earlier occasions.

public.

Royalty includes a consideration	Grant of distribution right by the foreign broadcaster
For the transfer of all or any right in respect of patent, invention, model, design, secret formula or process or trademark or similar property.	Distribution right is not in the nature of patent, invention, model, design, etc.
Imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trademark or similar property.	No information is being imparted by granting of distribution rights.
The use of any patent, invention, model, design, secret formula or process or trade mark or similar property.	As mentioned above, distribution right is not in the nature of patent, invention, model, design, etc.
The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill.	As mentioned above, no information is being imparted by granting of distribution rights.
The use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB.	Distribution right is not an industrial, commercial or scientific equipment.
The transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films.	In terms of section 14 of the Indian Copyright Act, 1957, the term 'copyright', inter alia, to mean the exclusive right to do or authorise the doing of any work or any substantial part thereof In the case of cinematograph film: i. To make a copy of the film, including a photograph of any image forming part thereof. ii. To sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy



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The primary controversy relating to taxation of advertising income in India that relates to determination of the place of accrual of advertising income so derived. In this respect, the case of Star Ltd. vs. DDIT 11 held that advertisement contracts are not contract for sale of goods; consequently the nature of advertising agreements could essentially be considered in the nature of contract for rendering of services. Based on this ruling, advertisement income would be said to accrue or arise at the place where the primary obligations under the contract for advertisement formed. Under the down linking model, given that the primary activity of displaying advertisements, broadcasting of the television channels carry on outside India, income accruing such contracts would be said to accrue or arise outside India, and consequently not taxable under the ITA. Similarly, taxability of advertising revenues remains disputed despite the broadcasters paying an arm's length remuneration to their Indian Associated Enterprises ("AE"), which act as agents for advertising sales. The position on attributability of profits in the event of arms' length compensation, has been settled by several rulings, most significantly in Set Satellite (Singapore) Pte. Ltd., BBC Worldwide v. DCIT 13, and the Mumbai Tribunal in B4U International Holdings v. Department of Income Tax.14 However, at the levels of lower authorities, there seems to be a persistent attempt to attribute profits of the non-resident to a permanent establishment ("PE") even on arms' length compensation. The disallowance of advertising sales and promotion expenditure incurred by the Indian Associated Enterprises of foreign broadcasting companies has raised several concerns. While it is contended that such expenditure is purely business expenditure and consequently should be allowed as a deduction, the tax authorities deny the deductibility of such expenses on the ground that such expenditure is primarily incurred for the benefit of the foreign broadcasting company, and therefore such companies ought to bear it. On this

position, the Bombay High Court recently ruled in favour of allowing expenditure; However the matter has been appealed by the authorities in the Supreme Court and is therefore sub judice. The controversy also arises on the question of whether tax should be withheld on the payments made to the entities as agency commission by broadcasters on advertising agencies, or as royalty payments, with broadcasting companies and tax authorities differing on this point. Resultantly, the non-withholding or short withholding of taxes has led to huge tax burdens on the broadcasting companies.

Taxability of income for the use of the satellite or transponder is an issue that has found conflicting opinions from various adjudicatory fora. As regards characterisation of subscription revenues, the question arises as to whether it is in the nature of business income or royalty, and this has been a matter of much controversy. While foreign broadcasters claim such revenues are business income, and therefore not subject to tax in India, tax authorities term such income as royalty and subject to 10% tax on a gross basis. The question here is whether payments for the use of a satellite by broadcasting companies, constitutes 'royalty' under section 9(1) (iv) of the ITA. There have been differing viewpoints on this issue; for instance in Asia Satellite Telecommunication Co. Ltd. the Delhi High Court held that no income accrued in India from the use of satellite outside India to beam signals for viewing in India even if the bulk of revenue arises from India. Similarly, in the case of Neo Sports Broadcast Pvt. Ltd the ITAT held that payment for licences for live broadcast of cricket matches was not 'royalty' under the ITA. The position has expectedly changed pursuant to the amendment to the ITA vide Explanation 6; accordingly, the Chennai ITAT in Balaji Communications, held that payment for satellite broadcasting rights constituted royalty under section 9(1)(iv) of the ITA and should be taxed. One would notice that even though the ITA has been retrospectively amended to specifically include satellite transmissions within the



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purview of section 9 and consequently held to be taxable, the position under the tax treaty remains unaffected by such amendment. Resultantly, since the taxpayer has the right to be governed by either the ITA or the tax treaty, whichever is more beneficial, the position would have no bearing in the context of foreign broadcasters claiming under a tax treaty. This position was reiterated by the Mumbai Tribunal in B4U International Holdings Ltd.

Another significant issue on which the broadcasting industry is at loggerheads with the tax authorities relates to withholding tax on payment for production of television programmes, carriage fees/ placement charges paid to MSOs and cable operators, and so on. Broadcasting companies claim that such payments attract tax deductible at source ("TDS") of 2% as payment for 'work' carried out by the recipients. Their rationale is that since the term 'work' has been defined in section 194C(iv) (c) of the ITA-as including broadcasting and telecasting including production of programmes for such broadcasting and telecasting- it must consequently be taxed as such. The tax authorities contend that such payments are in the nature of royalty/fees for technical services and consequently liable to be taxed at 10% and liable to be withheld under section 194I of the ITA. This aspect has come up particularly often with a large number of initial assessments by the assessing officer characterising such payments in the nature of royalty.

One must note here that while 194J is the provision for withholding of taxes on "royalty", section 194C is the provision that specifically applies to withholding in case of broadcasting and telecasting; based on established norms of interpretation, that the specific provision would over-rule the general provision, it should follow that tax on such payments must be withheld pursuant to section 194C. In case where the distribution rights granted by foreign broadcasters are in fact termed as 'royalty', the same would be taxed in case of foreign

companies under section 115A (1)(b) at the rate of 30%, 20% or 10% based on date on which such agreement was entered into.

The definition in the ITA of the term royalty refers to payment for use or right to use copyright. Since the term 'copyright' has not been defined under the ITA, one may take recourse to the Copyright Act, 1957. When section 14 is read in juxtaposition to section 2(y) and section 2(f) of the Copyright Act, 1957, it could be inferred that the 'copyright' means exclusive right to use the 'work' in the nature of cinematography¹⁷. Thus in order to have any right qua 'work', firstly there has to be a 'work' in existence. The live broadcast is not a 'work'. Thus, a right to broadcast a live event cannot be construed a right to use the copyright and therefore payments in relation to this right cannot be regarded as royalty.

Cost of acquiring content

a. Payment for acquisition of content to Indian companies

The content for broadcasting could be either owned by the content producer and the broadcaster is merely granted the right to broadcast, or such content could be produced by the content producer as per the requirement of the broadcaster. In the first scenario, the payment could be categorised as royalty, being payment for the use of a copyright, and accordingly there would be a withholding tax @ 10%18. However, in the second scenario, the payment would be categorised as payment for 'works contract'19,20 and tax would be withheld @ 2%.

b. Payment for acquisition of content to foreign companies

Withholding tax requirements on payments made to foreign companies would arise only when the said payment is taxable in India in the hands of foreign companies²¹.

Taxability under the Income-tax Act As discussed in the foregoing paras, under the ITA, an income would be taxable in India in the hands of a



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non-resident, if the income is received or deemed to be received in India, or accrues or arises, or deemed to accrue or arise to the non-resident.

If a non-resident is making payment to a non-resident content producer for acquisition of content for being broadcasted, the question of nonresident content producer having a business connection in India should not arise. Further, in any event if the non-resident content producer has a business connection in India, the income earned from providing content should not be attributable to the business connection in India. As regards the issue around "source of income", since the primary obligation of the content producer under the contract with the foreign broadcaster would typically be performed outside India, the source of such income of the content producer would not be in India.

Additionally it may be noted that a major cost for the broadcasters is in respect of content (commissioned or licensed). The taxpayers claim such cost as a revenue expenditure deductible in the first year or over the license period. In a few cases. However, the revenue authorities treated such content cost as an intangible asset.

Transponder charges

A transponder is a device for receiving and rebroadcasting a television signal. These devices are designed to receive signals from satellite uplink stations, amplify them for beaming over designated footprint areas, from where they are downlinked. Before downlinking the signal is encoded to ensure that only paying subscribers are able to access the signal. The peculiar activities performed by the satellite make payments by broadcasters to satellite companies a subject matter of tax controversy.

The income-tax department has been taking a view that the payment made by the foreign television channel broadcasters to another foreign company for utilising its transponder facility would be taxable in India basis that the satellite owners has a business connection in India. The department also takes stand that the payment is for the use of a process and/or for the use of equipment (i.e., transponder).

The Delhi High Court in the case of Asia Satellite Telecommunication Co Ltd²² held that:

- Merely because the footprint area includes India and programmes by ultimate consumers/viewers are watching the programmes in India, would not mean that the assessee is carrying out business operations in India.
- The payment was made by the foreign TV broadcasters in order to use the transponder facility and not for the use of transponder per se. In order to fall within the purview of "use of equipment", the payer ought to have control of equipment (i.e., satellite/transponder).
- No process (to amplify the TV programmes) was used by the foreign TV channel broadcasters and further, no such process had taken place in India.

To overrule the aforesaid decision of the Delhi High Court, explanation 5 and explanation 6 have been introduced by Finance Act 2012 to section 9(1) (vi) with retrospective effect from 1 June 1976, to clarify that the term royalty includes consideration in respect of any right, property or information, whether or not-its possession or control is with the payer, or is used directly by the payer, or is in India. It further clarifies that the term process includes transmission by satellite.



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However, it is important to note that aforesaid clarifications inserted in the definition of the term 'royalty' would not override the provisions of the DTAA entered into by India with the respective countries.

Contrary to the aforesaid principle, the Madras High Court in its judgement in the case of Verizon Communications Singapore Pte Ltd²³, by applying the retrospective amendment to the ITA to the India-Singapore DTAA as well, held that the consideration received by Verizon for providing integrated private leased circuit services within and outside India along with an Indian company to the Indian customers amounted to 'royalty' received for the use of 'equipment' as well as for the use of 'process' under the relevant provisions of the ITA and also the India-Singapore DTAA.

Channel distribution fee

As briefly touched upon above, a broadcaster may distribute the television channels through its own distribution network or engage an aggregator to distribute its channels. Where a foreign broadcasting company (FBC) distributes its television channels in India, it enters into an arrangement with a representative Indian company for channel distribution in India. In a channel distribution arrangement, the cable operator only retransmits television signals (on an as is basis), transmitted to it by a broadcaster/distributor without any editing, delays or interruptions. As mentioned above, since the definition of work under section 194C of the Act includes broadcasting, the subscription income paid by cable operators to the distributor ought to be subject to withholding tax as contractual payments under section 194C of the Act. It is important to note the difference between rights to channels distribution vis-à-vis right to channels copyright. In case of channel distribution fees, arguably, the same is meant to be consideration towards right to distribute channels and not for the purpose of exploitation of

any copyright in relation to the channels. Since the channel distribution fees shall always be payable by a broadcaster/ distributor to a resident cable operator, characterisation of such payments under the treaty would not have any bearing.

Channel placement fee

In rural areas where most television have sets have only one band being the "prime band" for displaying limited number of channels. Therefore, it is imperative for the broadcaster to find a slot in the prime band for enjoying higher television rating points (TRPs) and bettering it's advertising revenue prospects. The fees paid by broadcasters for appropriate channel placement in addition to channel distribution fees is typically referred to as channel placement fees.

As has been mentioned above, the definition of royalty includes consideration for use of any process. However, as may be noted above, the channel placement fee is a form of service fee and not signify any consideration towards a usage of a process. The over-arching retrospectively effective explanation to section 9(1)(vi) under the ITA, to interpret the term "process" ought not impact the above view on commercial services being provided qua channel placement. However, the tax authorities may seek to adopt a different view, as per prevailing experiences. Similar to channel distribution fees, since the channel placement fees shall always be payable by a broadcaster/distributor to a resident cable operator, characterisation of such payments under the treaty would not have any bearing.

Fees paid to MSO/cable operators/DTH operation for distributing channels

Broadcasters grant rights to distribute data content in Indian territory to Multi-System Operators ("MSO")/cable operators/DTH operators, a percentage of the revenues derived from the distribution of such content is paid to the foreign broadcasters as "license fees".



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Further, broadcasters also pay channel/ band placement fees to multi-system operators/cable operators for placing their channels on a preferred frequency/ band to enhance viewership of the channel. The tax authorities are of the view that such payments are in nature of royalty.

In case of Performing Rights Society Ltd. v. CIT and Metro-Goldwyn-Mayer v. CIT, it was held that such distribution in fact would be taxable in India, on the grounds that the fees payable are predicated on the exploitation of television content in India.

However, the Supreme Court in the case of CIT v. Carborandum had taken a contrary view and held that merely on account of the fact that the quantum of income accruing to the non-resident is contingent on exercise of such rights in India, the inference that operations were carried on by the non-resident in India, does not logically follow; in the absence of any operations carried out by the non-resident in India the income accruing to him from distribution of such rights cannot be said to accrue or arise in India.

With respect to domestic players typically, Explanation to s. 194C of the ITA, provides that the term 'work' inter alia, includes broadcasting and telecasting including production of programmes for such broadcasting or telecasting.

In this connection, reference is drawn to the decision of the Punjab and Haryana High Court in the case of Kuruksheta Karpans Pvt Ltd.24 wherein the court observed that the assessee was availing the receipt of 'telecasting signals' from the licensor. The expression 'service' had been referred in the agreement to mean the TV channel which was dealt with by the licensor and what the assessee had transacted for with the licensor included broadcasting and telecasting facility. Thus, it was held that the assessee was required to deduct tax at source in terms of section 194C on payments made to the licensor for obtaining TV signals for cable TV network owned by it.

From the above, a corollary could be drawn that the subscription income paid by cable operators to the distributor is subject to withholding tax. The tax withholding will be under section 194C of the ITA.

Further, reference is drawn to CBDT circular 715, dated 8 August 1995, wherein CBDT has clarified that TDS under section 194C of the Act will apply to payment made to advertising agency. Further, TDS provisions shall not be applicable on payments made by advertising agency to TV channels/newspaper company.

TDS on payments made by broadcasters or television channels to production houses for production of content or for television programme

The CBDT has issued Circular 04/2016 providing clarity on the law relating to withholding of tax on payments by broadcasters or television channels to production houses for production of content or programme for telecasting. CBDT has provided that payment for production of program/content shall attract TDS @ 2% as it would amount to consideration for carrying out 'work'. Accordingly, provisions of section 194C of the Act will apply.

Similarly, Circular No. 05/2016, has clarified withholding of tax implications on agency commission paid by television channels and publishing houses to advertisement companies for procuring or canvassing for advertisements. Here it has been clarified that no TDS is attracted on payments made by television channels/ newspaper companies to the advertising agency for booking or procuring of or canvassing for advertisements.

The CBDT has clarified that withholding tax as contractual payments (i.e., 2%) would be applicable for the first payment (i.e. by advertiser) and there would be no withholding tax on the second payment (i.e., by advertising agency).



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The CBDT has clarified regarding the withholding tax applicability on "the fees/charges taken or retained by the advertising agency" i.e. whether the same is in the nature of discount or commission. If this amounts to commission, withholding tax at 10% is applicable. It has been clarified that withholding tax would not be attracted on above payments made by the broadcaster to the advertising agency or on amounts retained by the advertising agency for booking, procuring, and canvassing advertisements. The above clarifications are also applicable for the print segments.

Film, music, animation and VFX

This section seeks to touch upon certain tax aspects pertaining to the Indian film industry.

Film distribution rights

The film distribution rights may be under a licensing model or a sale model. Under a licensing model, while the licensor continues to own the IP in the film, it grants distribution rights to the licensee for specified territories. Under the sale model, there is an outright sale of IP in the film to the transferee. Besides these two transaction models, film producers and distributors enter into diverse arrangements for exploiting various rights associated with a film. These rights may be categorised as theatrical and non-theatrical rights. Theatrical rights involve right to exploit the IP in a film through theatrical exhibition and is a conventional mode of exploitation of film rights. Non-theatrical rights include all other associated rights, viz. music rights, satellite TV rights, DTH rights, internet rights, etc. It is important to note the tax implications of transactions towards exploitation of these rights.

The "royalty" definition under the Act covers consideration for transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television

or tapes in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films. Thus, consideration received for sale, distribution or exhibition of cinematograph films is specifically excluded from the purview of "royalty". The key issues are as follows: first, what constituents a "cinematographic film", and second, whether license of distribution rights amounts to "sale, distribution or exhibition" for the purpose of the above exclusion. There are decisions of the High Court and the Tribunals on this issue – most of these decisions are in favour of the taxpayer, dealing with the exclusion to royalty definition (i.e., sale, distribution or exhibition).

Thus, with respect to acquisition of theatrical rights in case of Bollywood films, since such theatrical rights are licensed to resident entities who are liable to tax on their worldwide income, regardless of the medium of film distribution, withholding tax provisions on royalty payments would not apply on such acquisition of rights.

However, generally rights in Hollywood movies in India are typically granted by non-resident entities to Indian resident entities. By the same principle about exclusion of cinematographic films from the purview of royalty as defined, consideration paid to such non-resident entities would not be subject to royalty withholding tax in India. However, if such non-resident entities have any business connection in India, then profits attributable to business operations of such entities in India shall be taxable in India under the Act, subject to any tax relief under the tax-treaties.

Since the current law is silent on the definition of the term "cinematograph film", in relation to what is comprises of, in relation to non-theatrical rights, viz. music rights, satellite rights, etc. taxation of consideration for the non-theatrical rights under royalty will trigger.



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In case of composite arrangements whereby film producers grant both theatrical and non-theatrical rights for a lump-sum consideration, taxability and consequential withholding tax implications shall depend on firstly the ability to split the consideration on a rational basis and secondly on the dominant nature of the rights which determines the bulk of the consideration. Since ambiguities prevail on this count, tax controversies to this extent may be inevitable.

Line production services

The shooting of films entail logistics arrangements based on the location of such shooting. In such cases, the film producers may require such assistance or services from local entities, typically called line producers. The line producers generally render the services of cameramen, spot boys, stuntmen, choreographer, arranging accommodations for cast and crew, security personnel, insurance covers, arrangement of local permits, local transportation, etc. The issue involved in payments to line producers are whether line production services constitute Fees for Technical Services (FTS).

It is pertinent to note that the definition of work under section 194C of the Act includes production of programmes for broadcasting. The Hon'ble Delhi High Court has upheld the above principle²⁵. The Mumbai ITAT ruled that consideration for line producer services in relation to cinematographic films is contractual in nature and subject to withholding tax under section 194C of the Act and not under section 194J towards payment of professional services²⁶. Similarly in the context of line production services abroad, the Mumbai ITAT ruled the line production services are commercial services and do not partake the character of managerial, technical or consultancy services²⁷. Thus, the same should not be characterised as FTS. This principle was also upheld by the Authority for Advance

Rulings subsequently²⁸. It is important to note that most the tax treaties define FTS in relatively narrower manner than the Act. Accordingly, the principles rendered in the context of the Act ought to squarely apply even in the context of tax treaties. However, the definition of the term "Royalty" under the India Brazil tax treaty read with the technical explanation and protocol, may be wide enough to cover even payments similar to administrative services or line production services. Hence the beneficial provision under the Act may be resorted to in this case.

Deduction for cost of production of films

Rules 9A and 9B of the Income Tax rules 1962, deals with deduction of expenditure for production of films. Said Rules refer to exhibition of films on a commercial basis and are silent on the modes of such exhibition. Rule 9A provides for allowance of the cost of production of feature films certified for release by Board of Film Censors in particular year. Rule 9B deals with deduction in respect of expenditure on acquisition of distribution rights of feature films.

As per the said rules if the film is certified for release at least ninety days before the end of the previous year and the producer sells all rights of exhibition of the film, the entire cost of production/ distribution is allowed as deduction. If, the film is not released ninety days before the end of the previous year, the cost of production/distribution will be allowed such that it does not exceed the income earned from release of the film and the balance will be allowed to the next following previous year and allowed as a deduction. Moreover, Governments of certain countries offer grants/subsidies (film incentives) for shooting of films in that country. The issue which arises is regarding the tax treatment of such grants/subsidies i.e., whether grants/ subsidies should be considered as income or reduced from cost of production of the film.



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- The cost of production has to be reduced by subsidy received by the film producer under any scheme from the government as per the rules. One needs to consider whether the term "Government" in the rules includes foreign governments also.
- If this is not the case, considering the specific nature of rebate (which would be based on evaluation of such film incentive scheme), an issue arises that whether one may still reduce this from the cost of production.

The Tribunals have held that modes of exhibition should not be limited to theatrical but include other modes such as television.

With the growth of digital business and advent of new revenue streams, this is an important issue which the film industry is grappling with.

Post-production work including VFX is outsourced to a foreign company and the Indian film producer pays postproduction fees to such foreign company. In this regard, issues arises on taxability of such payment made whether the same is in nature of fees for technical services.

Taxability of non-resident for post-production activities outside India, should be analysed based on the relevant tax treaty²⁹ and existence of PE of such non-resident if any. Under the domestic law, it shall be treated as fees for technical services.

Withholding tax obligation on payment made by the Indian company for availing services outside India by an Indian in the course of production of a film

An India production house would quite often avail a number of services (technical, non-technical, professional, non-professional etc.) from outside India while shooting of film outside India. Mostly, these services are in the nature of arranging local crew, meals, shooting location, transport, equipment etc. In such scenario, one needs to analyse

the nature of payments and the withholding tax obligations thereon.

More specifically it needs to be analysed whether the services provided by the foreign parties are in the nature of "fees for technical services" or "commercial income".

Even if the said payments are considered as FTS under the domestic law, the assessee may argue that such services do not fall under the purview of technical, managerial or consultancy services under the tax treaties and therefore, is not taxable.

Deductibility of cost of production for abandoned films

Rule 9A of the Income Tax Rules, 1962 provides deduction in respect of the cost of production of a feature film certified for release by the Board of Film Censors in a previous year. In case of films abandoned, a certificate for release from the Board of Film Censors is not received. Thus, Rule 9A is not applicable in such cases.

The CBDT vide Circular No 16/2015 has clarified that in case of abandoned films, since the certificate of Board of Film Censors is not received, no deduction was allowed by applying Rule 9A of the Rules or by treating the expenditure as capital expenditure. In doing so, the CBDT relied on the decision of Hon'ble Bombay HC in the case of Venus Records and Tapes Pvt Ltd (ITA 310 of 2013). As Rule 9A is not applicable, the CBDT has clarified that cost of production of abandoned films should be treated as a revenue expenditure and deduction allowed under Section 37 of the ITA i.e., general business expenditure.

Taxability of a non-resident production house in India

The ITA specifically excludes from the scope of the income deemed to accrue or arise, the income of a non-resident individual, firm or company earned through or from operations which are confirmed to the shooting of any cinematograph film in India.



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Income of foreign producers should not be taxable in India in respect of operations confined to shooting of a film in India for transmission out of India based on an exemption under the domestic tax laws.

Taxation of foreign actors

Under the domestic provisions of the Act, section 115BBA of the Act deals with taxability of income earned by non-resident entertainer from performance in India. As per the said provisions the income arising to a non-citizen, non-resident entertainer (such as theatre, radio or television artists and musicians) from performance in India shall be taxable at the rate of 20% of gross receipts.

Taxability of foreign actors are covered under Article 17 of tax treaties (taxation of entertainers and sportsperson). Income from personal activities, as such, performed in India (i.e., performance in India) should be taxable in India irrespective of the actors' tax residency and whether or not such actor is an employee or on contract with an independent agency. In case performance income of such actor accrues not to the actor but to another person/entity, such income should still be taxable in India [Article 17(2)] pursuant to performance by the actor in India.

Tax implications on production of a film as a joint venture between a resident and a non-resident company

The joint venture ('JV') between a person resident in India and a non-resident, could trigger the risk of being an Association of Person ('AOP'). In case the JV is treated as an AOP, the entire income of the JV would be taxable at the maximum marginal rate in India.

In case where an Indian resident and a non-resident produces a film on JV basis and the parties agree to divide the rights attached to a film as opposed to share in net profits of the venture, it is possible to contend that each party should be assessed in respect of its share separately and that the AOP is not triggered.

Circular No.7/2016 dated 7 March 2016-following attributes should not constitute an AOP

- Each member is individually responsible for executing its part of work through its own resources and bears the risk for its scope of work;
- Each member earns profit/incurs losses based on performance within its scope of work;
- Men/materials used for an area of work are under the risk and control of the respective members;
- Control and management is not unified and common management is only for inter-se co-ordination for administrative convenience.

Income from music rights

Music rights are form of non-theatrical rights. It may also include the rights to mobile applications to incorporate tunes as part of mobile ringtones Deductibility of acquisition/license cost of music rights has been an issue in litigation. The taxpayers claim such cost as a revenue expenditure deductible in the first year or over the license period, while the Revenue authorities typically adopt a position that such acquisition/ license costs are an intangible asset. The courts³⁰ have upheld the taxpayer's claim of deductibility of music rights as a revenue expenditure.

Radio

Radio operators are required to pay license fees – one time entry license fee and annual recurring license fee to the Government. The issue under debate is regarding allowability of such license fees in the year in which it is incurred (or over the license period in case of one time entry fee) or such license fees should be considered as an intangible asset on which depreciation is allowable. Moreover the aspect of allowability of additional depreciation is worth considering.

Additional depreciation of 20% is allowed to taxpayers engaged, inter alia, in the business of manufacture or production of an article or thing. The issue which



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arises is whether additional depreciation is allowable to radio operators producing programmes. The Delhi High Court in case of CIT vs Radio Today Broadcasting Limited [2016] 382 ITR 42 has held that Radio programmes produced by assessee is 'thing', if not an 'article' which can have intangible characteristic and, therefore, when said programmes were produced by using plant and machinery acquired and installed after 31-3-2005. Hence the assessee's claim for additional depreciation is allowable under section 32.

Impact of introduction of GST on entertainment business

Movie tickets

During, the pre-GST era, in most of the States in India, cable operators, theatres, etc., were liable to pay entertainment tax levied by the local bodies of the States. The entertainment tax rates were in the range of 20%-30%, and in some States the taxes were levied beyond 40%.

After the introduction of new levy i.e., Goods and Services Tax (GST), entertainment tax was subsumed into GST and local bodies are instructed to levy no other taxes in order to avoid double taxation. Due to this, the prices of movie tickets had been reduced substantially and had been brought down to 18% (tickets upto INR 100) / 28% (tickets above INR 100). Vide a recent amendment dated 31 December 2018, GST rates on cinema tickets were further reduced to 12% and 18% respectively. This was a welcome move for the film industry at large.

However, pursuant to the above, certain State Governments (like Kerala) have decided to allow local bodies to levy entertainment tax on cinema tickets @10% GST rates. While this has created a distorted tax regime in limited space and jurisdiction, we can envisage a similar widespread inconsistency going forward.

Television

Under pre-GST regime, there was a dual levy of service tax @ 15% and Entertainment Tax (in the range of 8-12%) on broadcasting services (D2H/cable TV services). The introduction of GST has resulted in a single levy at 18% thereby reducing tax levy and increasing fungibility of credits.

Film distribution

Temporary transfer or permitting use of enjoyment of copyright relating to cinematograph films for exhibition in a cinema hall or theatre was chargeable to Service tax. IPR such as trademarks, copyrights were also treated as goods and attracted state VAT. Similarly, in case of certain lease of film/ television content rights, there was a controversy as to whether the transactions were that of a sale of goods or provision of service and hence, there was an issue of dual levy of Service tax and VAT on transfer of copyright for exhibition on television.

Under GST, temporary or permanent transfer of copyright or permitting the use or enjoyment of Intellectual Property (IP) right is to be treated as supply of services thereby putting an end to ambiguity on the applicable levy on such transactions.

Film production

Facility of centralised registration is done away with which has necessitated business to take state wise GST registration. Multiple registrations not only lead to increase in compliances but also complicate the transfer of services among offices of the same company. Owing to the same, Production houses are not able to claim input tax credit on cost incurred at outdoor shooting locations where they do not have a GST registration. For instance, renting of immovable properties (shooting locations).



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One more important issue is that in case of a film producer or a television content producer, GST rate for films or television content is 12%. The major portion of input in a film or a TV serial is services given by artists, technicians and other persons and various rentals paid which attract 18% GST. So major inputs are received with 18% GST credit but the output is charged at 12% GST rate. This perpetually leads to a situation of inverted duty structure for the business.

Sports Events

Taxability of sponsorship fees

Sponsorship fees is one of the key revenue streams for sports bodies/teams/players. Sponsorship arrangements include title/event sponsorship, team sponsorship, personal sponsorship of players, venue advertising, etc.

Typically, under the sponsorship arrangements, sponsors are granted various rights such as right to be described as official sponsor of an event, the right to advertise their product at the place of event, right to advertise their corporate name, etc. These rights provide benefit to the sponsors in the nature of marketing opportunity, enhanced corporate image, etc.

The sponsorship arrangement is akin to the advertising contract. As per the CBDT Circular 715, dated 8 August 1995 (for domestic payments), payment for sponsorship falls within the scope of payments under section 194C of the ITA. Further, the Delhi High Court, in the case of Sahara India Financial Corporation³¹ held that the payment for sponsoring an event is not in the nature of transfer of copyright or right to use the copyright and hence should not fall under the definition of royalty.

However, where the sponsorship arrangement indicate that the intention of association or use of trade mark/logo for the subject, the sponsorship fees in may fall within the purview of "royalty". A

typical situation would also arise where the right of each other's brand name are specified to be incidental rights or whether consideration is separately attributable to such incidental rights.

In case of overseas sponsorship fee payments, the revenue authorities have taken a position that the same is in the nature of royalty (which is subject to withholding tax) while the taxpayers contend that sponsorship fees are business income and not subject to withholding tax in the absence of a permanent establishment in India. On this issue, courts have upheld the taxpayers' contention that sponsorships are essentially in the nature of advertising contracts (as clarified by the CBDT in the context of withholding tax on domestic payments) and do not fall within the purview of royalty as per the domestic taw laws or tax treaty.

International sports event in India

Many international sport events are conducted in India vis. Formula 1, ICC events etc. Pursuant thereof, it would be necessary to understanding the taxability if the income generated from such event.

Issue to be evaluated here is that the sports events held in India is whether an event, as such, could constitute a permanent establishment/ business connection in India leading to tax implications for foreign companies. Whether grant of rights related to right to host, stage and promote event in India, whether such grant would create a permanent establishment in India.

The Supreme Court's in Formula One World Championship Limited's (FOWC) has held that Budh International Circuit is a Permanent Establishment (PE) of FOWC in India.

Key observations of the Supreme Court:

- Event has taken place by conduct of race physically in India.
- Entire income is generated from conduct of event in India.



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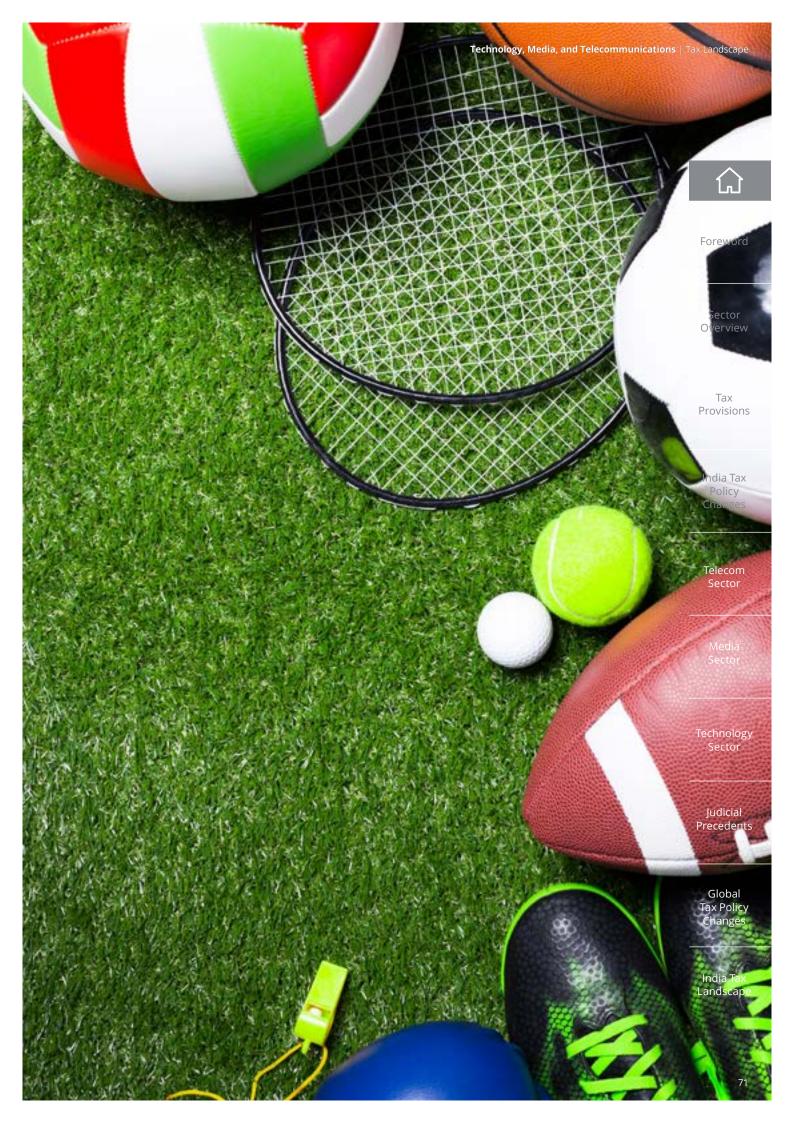
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- Budh International Circuit is a fixed place from where Grand Prix was conducted which is an economic/ business activity.
- Commercial rights are with assessee, which are exploited with actual conduct of race in India.
- During duration of the event (though for limited period of 3 days), assessee had full access to/complete control of the circuit (at the disposal of assessee).

Payment to sports persons

Taxability of sportspersons is covered under Article 17 of tax treaties (Taxation of entertainers and sportsperson). The income from personal activities of sportsperson, as such, performed in India (i.e. performance in India) should be taxable in India irrespective of whether or not such sportsperson is an employee [Article 17(1)]. In case performance income of such sportsperson accrues not to such sportsperson but to another person/entity, such income should still be taxable in India [Article 17(2)].

There are several complexities/issues in the context of taxability of revenue streams of players (e.g. whether training fees should be taxable and in which situations should training fees be taxable, taxability of image rights), attribution of income (e.g. if sports event is held in more than one jurisdiction) in case of sportsperson.

Taxability of crew should be evaluated based on criteria such as nature of services/contractual relationship, legal form of entity or individual, presence/period of stay in India, relevant tax treaty provisions.

Print Media

Foreign news agencies/newspapers

Foreign news agency or newspaper/ magazine/journal houses typically have a presence in India to facilitate collection of news from India. Income of such foreign news agency or newspaper/magazine/ journal houses should not be taxable in India with respect to activities confined to collection of news and views in India for transmission out of India based on an exemption under the domestic tax laws.

Taxability of print media under GST

Print media was exempt from service tax, while all other advertisement services were subject to service tax of 15%. Post introduction of GST, Selling of space for advertisement in print media attracts GST rate of 5% which enables advertisers to now claim input credit on all services procured by them.

New media

The growth of digital economy has given rise to emergence of new business models e.g., app stores, cloud computing. In such cases, the link or connection between revenue generating activities and geographical location is more obscured as compared to the past wherein a geographical connection with economic activity entailed taxation in the said jurisdiction. Digital economy poses challenges for the application of the existing international tax laws/framework. In this connection, some of the key issues to be examined are as follows:

- Existence of business presence/nexus with a jurisdiction.
- · Accrual/source of income.
- Characterisation of income In India.

There has been tax litigation on account of taxability of overseas payments for digital transactions such as, web hosting, data processing, data access/ subscription, software maintenance, online advertisements, online shopping.

Over-the-top (OTT) and Video-on-demand (VoT)

With the ease of high speed connectivity and access, viewing habits are rapidly changing which is looking for ondemand entertainment. With this, there is no longer need to sit in front of the television waiting for the favourite programme. A new medium in personal entertainment that has emerged over the past few years is over-the-top (OTT),



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a term used to describe delivery of entertainment (TV programmes, movies and music) via the internet, without consumers having to subscribe to a cable or satellite TV provider. Many traditional TV providers, including networks and multichannel video-programming distributors (MVPDs), are reevaluating their business models in order to adapt better to consumers' evolving habits. Video-on-demand (VoD) allows viewers to request immediate access to video content on their computers, television and smartphones; thus creating extensive opportunities for viewers to decide what they watch, when and how they watch it.

Owing to a significant rise in the use of smartphones and improved internet connectivity, consumers are increasingly embracing premium and subscription models to consume content. They are demanding high-quality and flexible original programming on demand and on numerous devices to satisfy their growing taste for 'binge viewing'.

In a typical OTT arrangement, OTT Foreign Co. pays consideration to foreign content providers to obtain a licence. It is necessary to analyse whether the type of online content and medium of display at present can be considered to be within the ambit of 'royalty income' under the Indian domestic tax laws as well as beneficial provisions of tax treaties. OTT Foreign Co. would need to evaluate its withholding tax obligations in India accordingly. Further, OTT Foreign Co. receives a consideration from India Co., advertisers and or subscribers. It needs to be evaluated whether this consideration qualifies as royalty (for copyright, process or equipment). Moreover, factors such as whether the content can be downloaded on subscribers' devices and its period of

validity will also have to be taken under consideration. Creation of permanent establishment of OTT Foreign Co. by Indian Co. from its activities/on the basis of number of users in India should also be analysed under the Indian domestic tax laws as well as in the context of Indian tax treaties. Moreover, revenues generated by the advertisements of Indian advertisers may be subjected to Equalisation Levy.

The foregoing discussions reflect certain fundamental tax aspects relevant to the Indian media sector. The analysis shall always be relentless and seamless in tandem with the evolution of the sector. It's therefore important to reiterate the need to constantly track the developments of this sector for evaluating the imperative tax aspects.



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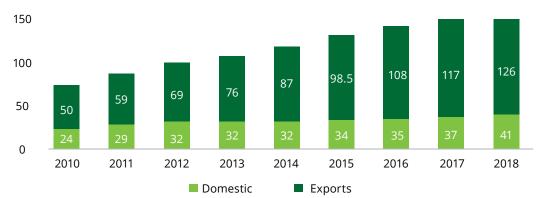
Technology sector: Key tax considerations

Technology at best is the consequence of science and engineering, its complexity a well-realised fact in any industry humanly conceivable. While, therefore the ambit of technology is broad to cover most scientific/engineering innovation to aid humankind and accelerate the clock of civilisation, this report, in alignment with the scope of Telecommunications

and Media sectors, seeks to focus on the tax issues confronting the Indian IT industry as the prime technology driver sector.

The Indian IT sector is a USD 167 billion industry with a CAGR of 10.71%. The major part of the revenue comes from export of IT services around the world.³²

IT, ITeS Sector Market Size In USD Billion



Source: Ibef

The IT industry has contributed a lot to socio-economic transformations across the globe and India has the coveted repertoire of being a preferred IT destination for the world because of its sheer talent and IT skillsets. The technology sector due to the inherent involvement of complex processes and knowhow, involves significant tax complexities and resulting controversies. Currently, e-commerce/digital PE taxation are at a nascent stage in India. However, with the advent of BEPS, Indian government is becoming increasingly sensitive not only towards the complex processes involved, but also about the tax laws of other countries and is thereby incorporating various amendments

under the ITA to target such companies. The various tax issues around current practices in the Indian technology sector are discussed below.

There are emerging technologies too, such as artificial intelligence (AI), Internet of things (IoT), which are also briefly touched upon, in the subsequent section dealing with the India taxation of the TMT industry and the road ahead. It may also be noted that the ensuing discussions are largely oriented around the taxation of non-resident enterprises, because corresponding tax implications in case of Indian tax residents are less debatable due to worldwide taxation principle for residents.



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Software Payments

Software can be categorised into the following types for the purpose of levying taxes:

- a. Packaged /shrink-wrap Software:
 - Packaged softwares are readymade applications. They are sold off-the-shelf to customers at retail outlets or can also be downloaded electronically. They are designed to meet the requirements of a variety of consumers. The common examples of packaged software include Microsoft Office, Norton Anti-Virus, Picasa, etc.
- b. Customised Software: Customised software are specifically tailor-made for a particular consumer to meet his special requirements. For e.g., an accounting software designed as per the specific requirement of a company.

The sale of software license gives the buyer the 'right to use' the software subject to certain terms and conditions. The buyer cannot resell or exploit it commercially for his own gain or profit. The buyer is not the "owner" of the software but a mere "licensee." Typically, in software licensing transactions, the licensee receives a limited right to use the software but cannot modify or replicate it.

Sale of software license is similar to selling a copyrighted article where the buyer gets to use the copyrighted article but not the copyright in the article. With this analogy, taxpayers contend that revenues from software licensing transactions are not for 'use of copyright', which can be taxable as 'royalty' in India. Such transactions shall be viewed as payments for 'use of a copyrighted article', which shall not fall within the ambit of royalty. However, many software companies were facing litigation with respect to the previously mentioned issue especially in cases of customised software. In light of the contradictory views taken by various courts, the software industry faced many tax uncertainties.

To clarify the position, the government brought the retrospective amendment to section 9(1)(vi), vide insertion of Explanation 4 by Finance Act 2012, wherein it has been clarified that the consideration paid for supply of software license will be taxable as 'royalty' in India. Accordingly, now whether the software purchased is off-the-shelf or customised, the same shall be taxable as royalty under section 9(1) (vi) of the Act.

However, post amendment to section 9(1)(vi), the CBDT issued a notification No. 21/2012 dated 13 June 2012 wherein resale of software without any modification by a resident transferor shall not be subject to withholding tax provided taxes have been withheld u/s 194J/195 from the payments made to the previous transferor. Presently, the issue is on the manner in which section 9(1) (vi) of the ITA will influence the position taken by foreign software companies under tax treaties. Based on the definition of 'royalty' under Article 12 of the OECD Model Convention, royalty includes consideration paid to obtain a right to use any copyright, i.e. the use of the copyright in the software and not the copyrighted article. The OECD Model Convention does not have within the ambit of the definition of 'royalty', the right to use computer software (including granting of a license). However, in light of varied court rulings on the subject, the position of law remains unsettled as to whether the consideration paid for purchase of software license will be classified as 'royalty' under the tax treaty. Litigation is inevitable until the Supreme Court decides on such issue and clarifies the taxation of payments for software.

Dual taxation of software

From an indirect tax perspective, the software industry has been on the receiving end of the decade-long dispute between the Central and the State Government to tax the sale of software. The plethora of judgments, both in the favour of the Centre as well as the State, only made the matter worse. While the Central Government treated sale



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of software as a service in the nature of development, designing, etc. of IT software, the State Government insisted that such transactions involve transfer of right to use the software, which shall constitutionally attract VAT.

In GST regime, there has been clarity on certain aspects of software transactions as specified in Schedule II of CGST Act wherein rights in goods is also considered as service. Hence, there is clear demarcation that supply of software is service unless it is sold as off the shelf which is considered as supply of goods. Further, the effective rate of taxes on software as high as 27% which has been significantly reduced to 12%/18% as the case may be.

Dual taxation on intellectual property

The declared list of services under Finance Act 1994, inter alia, included 'temporary transfer or permitting the use or enjoyment of any intellectual property right' (IPR), thus being liable to service tax. Almost all State Governments across India had classified "IPR" as goods and levied value added tax (VAT) on such transfer or licensing of copyright. Levy of service tax and VAT on the IPR transaction unduly increased the cost of doing business, especially if they are not available as credit to the recipient. As a result, the industry ended up paying both the taxes on conservative basis to mitigate interest and penal consequences.

However, after levy of Goods and Services Tax in lieu of Service Tax and Value added Tax, the issue of dual taxation on IPR has been resolved. While the levy is only guided as per GST provisions, there still remains issue on treating permanent transfer of IP in software as goods or services as there is an entry in the schedule of rates for goods and as well as services although rate of tax is same.

Electronic Commerce

Direct tax on digital businesses

Electronic Commerce (e-commerce) is a type of industry where the buying and selling of products or services is conducted over electronic systems such as the Internet and other computer networks. E-commerce offers a new way of conducting, managing and executing business transactions using modern IT.

BEPS Action Plan 1 has been introduced to address the tax challenges of the digital economy, aimed to consider whether international tax rules were sufficient to meet the demands arising from new business models and ways of creating value that are emerging with the rise of new technologies.

BEPS Action Plan 1 identified the following options in relation to issues arising out of Direct Taxation on conducting business through digital economy.

- Modifying the rules of exemption for Permanent Establishment.
- Creating new rules based on Significant Digital Presence.
- Virtual Permanent Establishment.
- Creation of WHT on Digital transaction.
- Equalisation levy.

In light of the above, recently the Finance Act 2018 has inserted Explanation 2A to section 9(1) (i), to provide clarification that the significant economic presence of a non-resident in India shall constitute "business connection" in India.
"Significant economic presence" for this purpose, shall mean:

a. Transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or



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- Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:
 - Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—
 - i. the agreement for such transactions or activities is entered in India; or
 - ii. the non-resident has a residence or place of business in India; or
 - iii. the non-resident renders services in India:

The threshold of revenue and users in India have not yet been indicated, but will be notified after consultation with the relevant stakeholders.

Currently, this concept of "significant economic presence" does not form part of any of India's tax treaties or the MLI. Thus, this amendment in the ITA shall be relevant for countries with which India do not have a tax treaty.

GST registration mandate for the e-commerce sector

In the GST regime every ecommerce operator was required to obtain registration irrespective of threshold. This in turn increases the compliance burden for start-ups in the initial phase of their businesses. The requirement for mandatory registration for e-commerce operator has been relaxed, wherein only the operators who are liable to collect tax at source shall be liable to obtain registration without the benefit of threshold. In other words, the e-commerce operators shall be entitled to the benefit of threshold if they are not mandated to collect tax at source.

The supplies wherein the e-commerce operator is not required to collect tax at source would mandate the supplier to obtain registration, irrespective of the threshold. On the other hand, under the pre-GST era, the SMEs engaged in supplying goods or services through

an e-commerce operator were not mandated to obtain registration, if their turnover didn't exceed the prescribed limits. Such SMEs were not required to expend their resources in compliances and payment of indirect tax. However, under the GST era the suppliers of goods are mandated to obtain registration irrespective of the threshold in cases where the operator is liable to collect tax at source, thereby necessitating tax payments and related compliances. While obtaining registration shall enable the SME sellers to claim input tax credit, it also poses difficulty caused due to increase in compliance cost and tax payments. The hassles associated with GST registration and compliance could act as a deal-breaker for the small-time traders who would have been outside the purview of GST if they didn't supply through e-commerce operator. Such traders may decide to shy away from e-commerce because of GST registrations and compliances.

Payment of tax and other compliance requirements by e-commerce operators

While under the inventory model, since the e-commerce operator assumes the role of the seller, the functioning and the taxation aspects may not witness a ground-breaking change with the introduction of GST.

In market-place model, the e-commerce operator acts as a facilitator extending a platform to the seller to sell its goods. Consequently, the e-commerce operator plays the role of a service provider and not a seller. However, the activities of e-commerce operator is misconstrued as activities of seller and therefore under earlier regime authorities in many cases have insisted the e-commerce operators to obtain registration under the VAT regime, pay taxes and undertake necessary compliances.

With the consolidation of the indirect taxes by introduction of GST, the delineation between the seller and service provider cease to exist. Things have thus become simpler for the



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e-commerce operators, who shall not be subjected to goods vs. services battle.

Cessation of Waybill compliance requirements by e-commerce operators

There has always been an ambiguity in identifying the person liable to undertake waybill compliances in terms of the erstwhile regime i.e., whether the seller is responsible or the e-commerce operator. Further, the onus to undertake compliances shifted from State to State. With the advent of GST, the e-commerce operator has been tasked with the responsibility to undertake the waybill compliances. With an arguable increase in responsibility at a PAN-India level, the e-commerce players will be happy to oblige as the approach is now uniform at a national level. This will help them maintain better control procedures or SOPs ensuring smooth operations.

Entry tax payments by e-commerce operators

Due to varying definition of 'Dealer' under State entry tax legislations, e-commerce operator had been considered as an importer in some States and was made liable to obtain registration, pay taxes and undertake related compliances. Different State authorities interpreted the functioning of the sector in different manner. The Courts have pronounced divergent verdicts, which further disappointed the sector. Now that the entry tax is subsumed into GST, the e-commerce operators can heave a sigh of relief.

Input credit pool for the suppliers in electronic services sector

The stakeholders involved in a supply through an e-commerce operator incurred notable losses in form of ineligibility of taxes paid at various stages of supply chain. For instance, the taxes paid for procurements of goods/capital goods by a marketplace, inter-State procurement of goods, etc. Considering the nature of transaction and complexity, credit blockage at various stages of supply chain under earlier regime, in case of e-commerce model

was inevitable. The introduction of GST with the primary objective of avoiding cascading effect of taxes, ensured that the e-commerce operators were entitled for seamless input tax credit. This will ensure substantial reduction of cost and uniformity of treatment to procurements at a PAN-India level. The substantial increase in ITC has the potential to boost the sector and will clearly eclipse the challenges faced by the sector due to registration mandate, collection of tax at source, etc.

On the other hand, non-resident OIDAR service provider providing services to unregistered persons (B2C) in India are required to register in India and pay taxes under GST. However, most of the OIDAR service providers do not have place of business in India and all business operations are conducted outside India. Accordingly, certain expenses which accrue to such business entities (like agent fee [intermediary]) shall not be eligible for credit and hence this leads to blockage of credits to OIDAR service providers.

Tax collection at source

The GST law mandates e-commerce operators to collect tax at source in respect of the supplies made through its portal. The liability to collect tax at source shall arise only if the consideration in respect of supplies is collected by the operator. The operators are expected to collect tax at source and deposit in each State where the supplier is located, thus making it mandatory for the operator to obtain registration even in the States where it has no existence. A relief has been extended to the e-commerce operator allowing them to declare the head office as the place of business in those States where it does not have any presence. Each State has indicated one administrative jurisdiction where all e-commerce operators (who does not have presence in that State) can register. Since this requirement did not exist under the earlier regime, the tax collection and related compliance may involve notable increase in cost for the e-commerce operator.



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The other side of the coin is the impact of TCS provisions on the suppliers. The collection of tax at source could have an adverse impact on the margins of the supplier. TCS could act as as a pain-point not only to the large suppliers, but also to the SMEs who have to deal with increased cost on account of the registration and other related compliances. This could discourage the suppliers, especially the SMEs to operate through the e-commerce portal as it will not only imply registration compulsion, but will also be subjected to collection of tax at source.

The requirement to collect tax at source and undertake necessary compliances, have been notified to be effective from 1 October 2018. The implications on the overall e-commerce business are yet to be seen.

Tax deduction at source

The concept of TDS was initially introduced in the Income Tax Act and has now been introduced in GST as well. The purpose of introduction of TDS on GST is only to enable the government to have a trail of transactions and to monitor and verify the compliance. It acts as a powerful instrument to prevent tax evasion and expands the tax net, as it provides for the creation of an audit trail. Similar to the Income Tax Act, the person deducting the TDS is required to deposit the TDS with the government and issue Form 16 and Form 16A, similarly under GST Act as well, the person deducting the TDS would be required to deposit the same with the government by the 10th of the next month and issue relevant Form to the person whose TDS has been deducted.

While the concept of TDS was prevalent to a limited extent under State VAT Laws on works contracts wherein the underlying supply involved sale of goods in the contract, the concept of TDS under GST is a fairly new concept and has initially been implemented with effect from 1 October 2018 on notified recipients of goods and services which include Department or Establishment of the Central Government or State Government, Local Authority,

public sector undertakings Government Agencies and such other categories. The present rate of GST TDS is 2%, which would need to computed on the payment made or amount credited to the supplier where value of supply of goods or services or both exceeds INR 2,50,000.

Valuation in case of discount funding

It is a well-known fact that the Indian markets are price-sensitive. The optimal approach which is tried and tested, is ensuring customer acquisition and retention by way of discount funding. The new entrants in the e-commerce sector have all adopted this strategy for penetrating into the Indian markets. This is one of the reasons why in-spite of huge losses incurred by the eminent e-commerce operators, their valuation runs into Billion \$. While the said approach may be working wonders from a commercial perspective, the taxation aspect of the approach also needs to be considered.

It has been witnessed that the evolution of indirect taxes in a country emanates from the development of trade and commerce in that economy. While the Indian economy has welcomed the e-commerce sector with open arms, it will be fair to say that the consequent evolution of the tax landscape was not a huge success. The e-commerce operators were subjected to litigation without proper understating of the functionalities and modalities of the business. An ideal example of the same will be tax sought by the state authorities on the discounts offered by the e-commerce operator. This discount is the difference between the amount charged by dealer for sale of goods and the amount at which such goods are sold to consumer. This approach by the tax authorities add to the losses of the entities, thus making it not only difficult to grow, but also to sustain in this competitive market. The sector will expect the government to appreciate the functioning of the sector considering the price sensitivity of Indian retail markets and frame tax laws accordingly, failing which, there will be little left to tax.



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Cancellation and sales return

The huge quantum of sales return and order cancellation is peculiar to the Indian e-commerce sector. As e-commerce model also operates on cash on delivery, the instances of customer cancelling the order before delivery, refusing to pay for being not satisfied with product, are relatively high. Such cases lead to rejection of the claim for deduction from tax amount due to sales return. Further keeping records of cancellation of order and sales return becomes difficult and thereby substantiating the deductions from tax liability before authorities also becomes difficult. Not permitting the suppliers to adjust the liability on account of cancellation or sales return could compel the SMEs to go out of business.

Non-eligibility of composition scheme

While obtaining registration is mandatory for suppliers making supplies through an e-commerce operators, they are ineligible for opting the composition scheme. This may not only impact the suppliers but also the consumers in case of retail e-commerce. The consumers end up paying higher amount of tax as against the nominal rate of tax that would have been paid by supplier, had the composition scheme been eligible.

Ownership of Websites

The issue faced by the website owners is regarding the "place of business" of the website. A website is hosted on at least one web server, accessible via a network such as the Internet or a private local area network. Thus, for knowing the 'situs' of the website one needs to know as to where the server on which the website is hosted, is located.

The OECD commentary mentions, "An Internet website, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore, does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances machinery or equipment" as far as the software or data constituting that website is concerned. On the other hand, the server on which

the website is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server".

Here however, it needs to be highlighted that the website owner will be deemed to constitute a fixed place PE only if the server on which the website is hosted is at the disposal of the website owner. In addition, if the server is not under the control of the website owners, the payments made by the website owner for the use of server will not be characterised as royalty as per Explanation 2 of section 9(1) (vi) of the ITA.

The Mumbai Tribunal in the case People Interactive (I) P Ltd held that payments for website hosting could not be treated as 'Royalty' under the ITA or India-USA tax treaty. The Tribunal held that the taxpayer could not operate or even does not have physical access to the equipment system. Further, the taxpayer is not using equipment but only availing the services provided by a non-resident. Therefore, such payments cannot be treated as 'Royalty' under the ITA or under the tax treaty.

Fees for advertisement on websites

Online advertising/internet advertising uses the Internet to deliver promotional marketing messages to consumers and includes email marketing, search engine marketing, social media marketing, web banner advertising

The issue that requires analysis is whether any consideration paid for such advertisement to the foreign website owners will be taxable in India.

The Finance Act 2016 introduced a new concept of Equalisation Levy, with the intention of taxing the digital transactions i.e. the income accruing in India to foreign e-commerce companies. It is aimed at taxing business-to-business transactions. The following services covered within the ambit of equalisation levy:



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- Online advertisement
- Any provision for digital advertising space or facilities/ service for the purpose of online advertisement

Equalisation Levy is a tax, which is withheld at the time of payment by the service recipient to the services provider. The conditions to be met to be liable to equalisation levy are:

- The payment is to be made to a nonresident service provider.
- The non-resident does not have a PE in India.
- The annual payment made to one service provider exceeds INR 1,00,000 in one financial year.

Currently the applicable rate of tax is 6% of the gross consideration to be paid.

Another important amendment under the ITA in the field of online advertisement is the introduction of the concept of "significant economic presence" vide Finance Act 2018. As per the said amendment, if an entity has a significant economic presence in India it can constitute a business connection of the non-resident in India in terms of section 9(1) (i) of the ITA. One criterion prescribed for determination of significant economic presence is by way of systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

Certain relevant concepts of online advertisement, which may be important for analysing the impact of the previously mentioned amendment, are explained below.

Cost per miles (CPM) or cost per thousand (CPT) is the cost an advertiser pays for one thousand views or impressions of an ad campaign.

- Cost per click (CPC), also called pay-perclick (PPC) is a related concept that is a more defined cost item as it relates to the cost paid by an advertiser every time a website visitor actually clicks on the advertisement. It is calculated by dividing the advertising cost by the number of ad clicks.
- Cost per action/acquisition (CPA), also known as pay-per-acquisition (PPA) is a further specific tool where the advertiser pays if the ad viewer performs specific actions, most common being actually purchasing the product or registering with the advertiser (like signing up for newsletters, registrations, etc.)

In online advertising, it is possible to keep a track of the number of users as well as the related revenue generation, by way of CPA, CPC. While one awaits the final guidance from CBDT, the above concepts could be used as a criterion to determine the number of users and establish that the advertisement platform has a significant economic presence in India.

User fee paid for registering on website

There are various websites wherein the seller and buyer have to register in order to carry out the transaction of sale and purchase of goods online. This mode of transacting is a preferable one if the seller of the goods does not have its own website for online selling. For registering on such websites, the seller will have to pay a user fee to the website owner.

The issue, which arises, is whether such user fee paid by the seller of goods to the foreign website owner will be taxable in India.

Certain judicial rulings have held that fees paid to a foreign company for registering on its website are not fees for technical services. A foreign taxpayer may provide its platform to the Indian trader for online purchase/sale of goods. The fee paid by the Indian trader to the foreign company



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for use of such platform will not be fees for technical services under section 9(1) (vii) of the ITA as there is no managerial, consultancy or technical services provided by the foreign company.

However, in light of the amended definition of business connection one has to also examine the implications of the concept of significant economic presence in this regard.

Deduction under section 10AA

Section 10A of the ITA provides for deduction of profits and gains derived by an undertaking from export of articles or things or computer software

manufactured or produced by it in any special economic zone, free trade zone, software technology park, electronic hardware technology park. The deduction was available for such undertakings up to 31 March 2012.

Section 10AA provides for a tax holiday in respect of an assessee from an SEZ unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1 April 2006, but before the first day of April 2021. The claim of deduction is subject to prescribed conditions and compliances.

Period	Percentage of 'export' profits
First 5 years	100
Next 5 years	50
Next 5 years(*)	50

(*)Up to 50% of profit provided it is debited to reinvestment reserve-reserve only to be used for plant and machinery purchase within 3 years of creation

As per section 10AA, certain expenses such as insurance, freight, telecommunication expenses, which are attributable to delivery of goods or computer software outside India, or expenses incurred in foreign exchange in provision of technical services outside India are to be excluded from the export turnover while calculating the deduction under section 10A/10AA.

While calculating the deduction under the previously mentioned sections, the profits attributable to the export turnover vis-à-vis the total turnover is allowed as a deduction. The issue here is that when certain expenses are reduced from the export turnover, should the same also be reduced from the total turnover while calculating the deduction under section 10A/10AA.

The tax department takes a view that as per the said sections, reduction of the previously mentioned expenses is only from export turnover and the same should not be reduced from the total turnover. This controversy has remained unsettled until recent times in light of the varied decisions in this regard.

However, recently the Supreme Court in the decision of HCL Technologies Ltd. has settled the previously mentioned issue by holding that reduction of the expenses from only the export turnover but not from the total turnover will give rise to inadvertent result, which will cause grave injustice to the taxpayer. Thus, the Supreme Court held that what is excluded from 'export turnover' must also be excluded from 'total turnover', since one of the components of 'total turnover' is export turnover.



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Another relevant issue is regarding the allowability of deduction under section 10AA in case of units formed by splitting up, or the reconstruction, of a business already in existence. As per sub-section 4(ii) of section 10AA, the deduction under the said section shall not be available if the unit is formed by the splitting up, or the reconstruction, of a business already in existence.

The issue is whether the condition of splitting up or reconstruction of a business already in existence is to be looked into in the first year when the deduction is claimed or in each of the years. The tax department in certain cases have initially allowed deduction under section 10AA in case of splitting up or reconstruction of an existing business. However, in subsequent years it denied the said deduction on the ground that the unit was formed by splitting up or reconstruction of the existing unit.

In this case, the courts have taken a view that if eligibility of deduction under section 10AA has been accepted in initial assessment year, then it cannot be withdrawn in subsequent years for breach of certain conditions which are required to be seen or examined in the first year of claim.

Certain IT/ITeS Tax Issues

The IT and IT enabled Services (ITeS) sectors has transformed India's image on the global platform, which has in turn led to economic growth of the country. India has been considered as the hub of IT/ ITeS sector in light of the enormous talent available at very economical cost.

This sector has developed rapidly in the past two decades resulting in an increased interest by the tax authorities in analysing companies in the said sector. One of the contentions by the tax authorities is that the back office work performed by the Indian companies for the foreign entities is the business of the foreign entity being carried out in India. Accordingly, allegations have been made that outsourcing companies are the permanent establishment of its parent company for whom they carry out the outsourced work without appreciating the fact that the outsourcing company in India are independent corporates having its own distinct legal identity.

This position is more or less settled by the Supreme Court decisions in the case of E-Funds IT Solution Inc. & Morgan Stanley & Co., wherein it has been held that the outsourced services carried out by the Indian entity is not the business of the foreign entity being carried out in India but only support/ancillary to the main business of the foreign entity.

Another major issue faced by the IT/ITeS companies is regarding the deputation of personnel to the Indian entity. The stay of such personnel in India may vary depending on the work expected to be performed by them. Accordingly, based on the facts, there may be exposure for the foreign entity of having a fixed place/ service permanent establishment in India in the form of such deputed personnel. If the stay of such expats is for a very short duration and the activities performed by them is in the nature of stewardship functions then such personnel may not be considered as providing any services to the Indian entity. Thereby, such personnel shall not form a services PE for the foreign entity in India. However, if the stay of the deputed expats is for a long duration and the nature of activities are not stewardship then such expats may be considered as providing services on behalf of the foreign entity to the Indian entity. This will entail a service PE exposure for the foreign entity in India.



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Many companies started deputing expats to India by transferring them on the payroll of the Indian entity. The Indian entity in this case is considered as the legal and economic employer of such expats. However, the tax authorities have, in many cases, ignored the said arrangement and alleged a PE of the foreign entity in view of the presence of such expats in India. Indian Courts have expressed diverse view on the said issue. However, the common parameter, which the courts have highlighted, is that if the expat deputed to the Indian entity continues to have lien over his employment with the foreign entity then the said expat shall in substance continue to be considered as employee of the foreign entity. Thereby, the PE exposure for foreign entity shall continue in this scenario as well. However, it may be highlighted that even if the foreign entity is said to have a PE on account of deputation of expats in India, if the consideration for the transaction is at arm's length price then there shall be no further profits attributable to the PE of the foreign entity in India. Here it may be possible to take a view that in case the foreign entity is said to have a PE in India then while computing the business profits of the PE under Article 7 of the tax treaty, payment received by the foreign company is to be treated as revenue receipt (i.e., say reimbursement of salary cost by Indian entity to foreign entity) and any cost incurred has to be allowed as deduction (i.e., salary is a cost to the PE). Thus, it may be a zero sum game even if the foreign entity is considered as having a PE in India. However, the said view may be litigative and the tax department may try to attribute certain portion of the profits of the foreign entity in India.

Refund of ITC on Capital Goods for Exporters

As per Section 54(3) of CGST Act, 2017 exporters will be eligible to either claim a refund of unutilised input tax credits or refund of tax paid. However, as per the formula prescribed for refund of unutilised credits, in GST rules, the 'Net

ITC' which is defined as ITC on inputs and input services only. In the erstwhile regime, capital goods had a restrictive meaning limited to specified excise chapter headings and therefore the rest of the goods were covered as part of inputs and were entitled for credits subject to certain conditions.

In GST, all capitalised assets are considered as capital goods, therefore the purview of eligibility for refund is reduced substantially since formula only covers inputs and input service. Hence, there will be blockage of taxes paid on capital goods for exporters.

Blockage of Credits on Certain Supplies under GST Regime

Before implementation of GST, Service Tax and VAT was applicable on Services and Goods respectively. Also, there was no cross utilisation of these credits between themselves. Due to this there was blockages of huge taxes, as the credit of Service Tax cannot be set-off against VAT and vice versa. However, after implementation of GST, the issue of cross utilisation of credits is reduced substantially. However, due to certain provisions of place of supply, which determine the type of taxes to be applicable on specific transactions, the businesses are not able to avail the credit of taxes. For example, A Ltd registered in Delhi had received an invoice from B Ltd located in Maharashtra towards admission to an entertainment event held in Mumbai, with CGST and MGST, then A Ltd cannot avail the credit of CGST and MGST and hence such taxes are cost to A Ltd. This is detrimental to the objective of GST which was introduced to bring seamless credits to business and reduce tax cost to customers.

Cloud Computing

Cloud computing is a technology that uses the Internet and central remote servers to maintain data and applications. It broadly means virtual servers available over the Internet. It allows for much more efficient computing



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by centralising storage, memory, processing and bandwidth. It is a way to increase capacity or add capabilities without investing in new infrastructure, training new personnel, or licensing new software.

In these technology-oriented times, cloud computing can be defined to be a model for delivering on-demand, self-service computing resources with a universal network access, that has location independent resource pooling and a payper-use business model.

A simple example of cloud computing is Yahoo email, Gmail, etc. One does not need software or a server but merely an Internet connection to use them.

Three types of Cloud Service Delivery Models

a. Infrastructure as a Service (laaS) or Hardware cloud

Large and costly infrastructure like servers, equipment, network infrastructure, etc. are provided by the Cloud Computing service provider under the said model.

Software as a Service (SaaS) or Software cloud

SaaS software vendors host several software applications on the hardware for the users to use as and when required.

c. Platform as a Service (PaaS) or Desktop cloud

The software developers can avail the platform services to develop various applications without installing and maintaining any tools on their computer. Like the challenge in taxing any digital economy business model, a question remains on taxation of cloud computing services. The main issue could be that of characterisation of the consideration for cloud computing services under the domestic law as well as tax treaties. Further, one will also have to examine the implications of the concept of significant economic presence in the context of cloud computing.

The tax implications under cloud computing will all depend on the classification of the transaction. It would be relevant to determine whether the income from rendering cloud services (under various service models) could be characterised as income from rendering of services or income from sale of software or income from lease of software/hardware or a mix/ combination of all. This is because the characterisation of the income would lead to determination of the tax liability including withholding tax implications either on a net basis (i.e., taxable as business income) or gross basis (i.e., taxable as either royalty or fees for technical services or business income). There may also be an issue of constituting a fixed place PE depending upon whether the control over the server/equipment has been transferred to the customer.

Based on the foregoing, it may be appreciated that the key income tax aspects typically under consideration in the Indian technology space, comprise of taxation of royalty, fees for technical services and permanent establishments as regards payments to non-residents.



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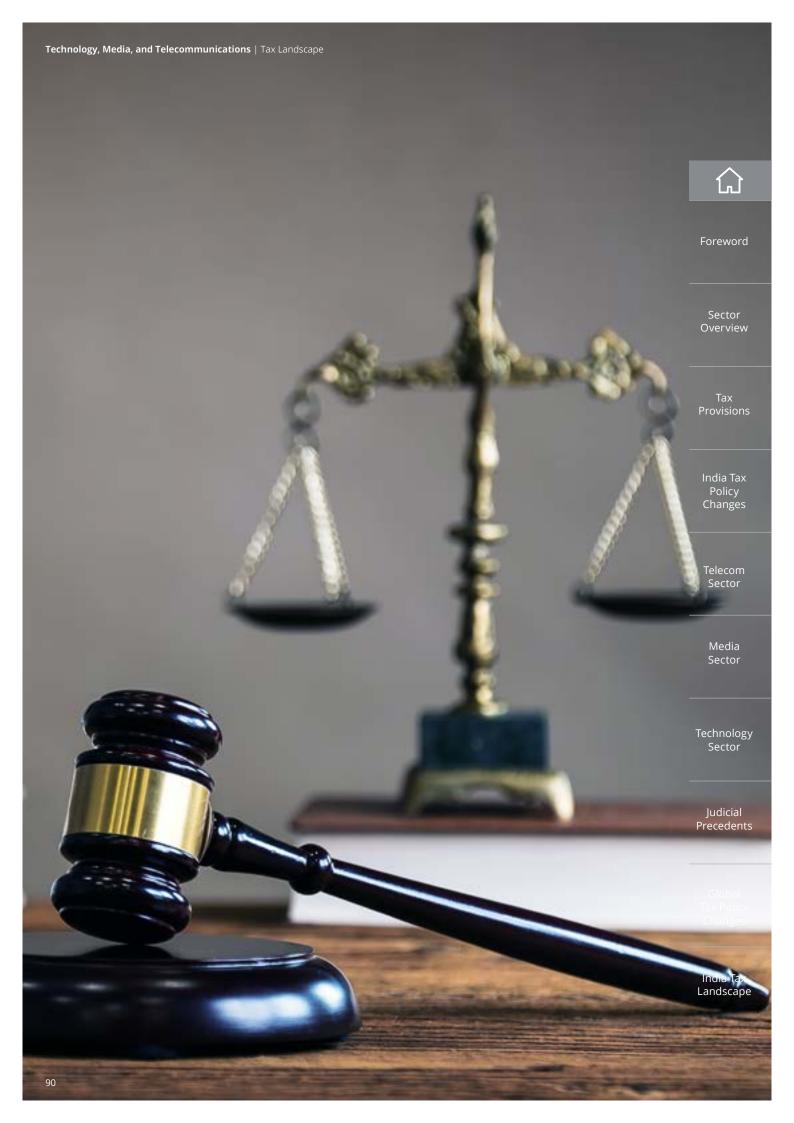
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India Tax Landscape

Telecommunications

The upsurge of telecommunications industry in India has also attracted the attention of the Indian tax judiciary, which has dealt with certain tax issues

in the telecommunications sector in the recent past. We have summarised the key judicial precedents.

Income tax issue

Decision

Supply of hardware such as equipment/ mobile handsets

01. Supply of equipment without any software not taxable

- a. CIT vs. Daimler Chrysler AG [2012](52 SOT 93)
 Activities of the foreign supplier (of delivering equipment) performed outside India would not create any business connection of the foreign supplier in India.
- b. Ishikawajma-Harima Heavy Industries Ltd. [2007] 158 Taxman 259 (SC) The Apex Court held that income arising out of operation in more than one jurisdiction would have territorial nexus with each of the jurisdiction on actual basis. Thus, it may not be correct to contend that the entire income "accrues or arises" in each of the jurisdictions. Hence, where supply of equipment is outside India, it cannot be deemed to accrue or arise in India even if the services are supplied in India.

02. Supply of equipment with embedded software not taxable as royalty

Purchase of equipment with embedded software cannot be segregated into purchase of equipment and purchase of software separately. The software being inbuilt in the equipment is an integral part of the same. The predominant purpose of the purchaser is to purchase the equipment and not the software embedded in it. The consideration is paid towards purchase of equipment, of which software is an inseparable part and incapable of independent use and the same should be regarded as being towards supply of goods. Consequently, no part of the payment can be classified as "royalty".

The above has been upheld by the Courts in the following cases:

- a. Reliance Communication Ltd [2018] 90 taxmann.com 358 (Mumbai-Trib.)
- b. ZTE Corporation [2017] 392 ITR 80 (Delhi HC)
- c. HITT Holland Institute of Traffic Technology B.V. vs. DDIT (International Taxation) [2017] 78 taxmann.com 101 (Kolkata-Trib.)
- d. DIT v. Ericsson A.B. (246 CTR 422)(Delhi High Court)[2011],
- e. DIT v. Nokia Networks OY (253 CTR 417)(Delhi High Court)(2012)
- f. CIT v. Neyveli Lignite (243 ITR 459)(Mad)[2000],
- g. Motorola Inc. v. DCIT (95 ITD 269)(Del)(SB)[2005]
- h. Qualcomm Incorporated-[2013](30 taxmann.com 30)(Delhi-Trib.)/ [2018] 93 taxmann.com 80 (Delhi-Trib.)
- i. Siemens Aktiengesellschaft-[2013](33 taxmann.com 480)(Mumbai-Trib.)
- j. Alcatel Lucent Canada [2015] 372 ITR 476 (Delhi) Supreme Court has granted the Special Leave Petition filed by the Revenue
- k. Reliance Infocom Ltd. [2013](39 taxmann.com 140)(Mumbai-Trib.)
 The Mumbai Tribunal has reiterated the principle that when software is supplied as an integral part of the equipment, the payment is not royalty and in cases where the software is supplied separately and not as an integral part of equipment such payments will be taxed as royalty.

Decision

l CIT vs. Sunray Computers (P.) Ltd. [2012](348 ITR 196)(Karnataka)
The assessee purchased software and hardware from two different nonresident companies, integrated them for manufacturing and supply of
telecommunication equipment. In this case, the High Court held that in
view of the fact that assessee's transaction for purchase of software was an
independent transaction, payment made for it amounted to royalty under
section 9(1)(vi) of the ITA.

03. Supply of equipment and installation

a. Nokia Networks OY [2018] 94 taxmann.com 111 (Delhi-Trib.) (SB)

The assessee, incorporated in Finland, was engaged in the manufacture of advanced telecommunication systems and equipments (GSM Equipment), which are used in fixed and mobile phone networks; and trading of telecommunication hardware and software. The assessee sold equipment to Indian telecommunications operators and also entered into certain contracts for installation. After the incorporation of the subsidiary, the existing installation contracts were assigned to the subsidiary, and thereafter all installation activities were carried out by it under separate agreements with Indian telecommunications operators. The assessing officer held that the Indian subsidiary is the PE of the assessee in India. The Tribunal held that the assessee has not carried out any activity other than offshore supply, and therefore any activity performed by the Indian subsidiary under independent contract cannot be reckoned to constitute a PE. Further, the assessee has not performed any activity under the independent contract of the subsidiary and its customers, from which it has received or accrued any income in India or through an asset in India. Although the guarantee was given by the assessee, the Indian subsidiary entered into the installation contract directly with the customer. Income from this contract was duly offered to tax. Accordingly, the Indian subsidiary is not the PE of the assessee in India.

The dissenting member of the Special Bench has rejected the assessee's plea and is of the view that when a subsidiary company is merely an alter ego, or virtual projection of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a PE of the parent company in India.

Connectivity charges paid to telecommunications operators

01. Connectivity charges paid to domestic telecommunications operators not taxable as FTS/royalty

a. Gupshup Technology India (P.) Ltd. [2017] 78 taxmann.com 11 (Mum Trib.) Assessee was engaged in sending SMS for which it availed services of a telecommunications operator. The payment made by the assessee for availing the said services, even if for standard connectivity charges, could not be considered as "royalty". The deductor neither has any access/ control over the equipment nor is there any usage of any process/ equipment, which could be made available to the deductor.



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b. Skycell Communications Ltd. [(2001) 251 ITR 53](Mad)
Usage of technology for providing services does not bec

Usage of technology for providing services does not become technical services, and thereby airtime charges and call charges raised by the telecommunications companies cannot be subject to any tax deduction at source under the provisions of the ITA. The High Court explained that when a person decides to subscribe to a cellular telephone service to avail the facility to communicate with others, he does not receive a technical service. Instead, he agrees to pay for the use of the airtime. The fact that the telephone service provider has installed sophisticated technical equipment in exchange to ensure connectivity to its subscriber, does not make it provision of a technical service to the subscriber. The subscriber is not concerned with the complexity of the equipment installed. All that he wants is the facility of using the telephone when he wishes to, and being able to get connected to the desired person.

c. Vodafone Essar Ltd. (131 TTJ 385)(Mum Trib.)

The issue was whether national roaming charges could be regarded as rent for "use of equipment" under section 194I and thus, liable for withholding tax. The taxpayer entered into an agreement with IDEA Cellular Ltd., whereby a subscriber of a cellular network can also gain access to the services of any other network operators in their respective licensed area for a specific charge called as national roaming charge. The Tribunal held that the payment of roaming charges for use of the visited network cannot be regarded as for use of equipment and would thus, not be subject to withholding tax.

- d. Vodafone South Ltd. [2016] 72 taxmann.com 347 (Karnataka HC) Payment made by the assessee to another mobile service provider for utilisation of roaming mobile data and connectivity could not be termed as technical service and, therefore, no TDS was deductible under section 194J of the ITA.
- e. Vodafone Digilink Ltd. [2017] 87 taxmann.com 315 (Delhi Trib.)

 The Tribunal held that if the assessee, engaged in providing telecommunication services, is paying roaming charges to other telecommunications operators for allowing use of their network to assessee's subscribers, the same were in nature of provision of a standard facility. Provision of this facility did not involve any human intervention at all and hence, such payments could not be classified as FTS liable for deduction of tax at source under section 194J of the ITA.
- f. iGATE Computer Systems Ltd. [2015] 53 taxmann.com 431 (Pune-Trib.) The Tribunal held that where assessee, a software company, paid data link charges for utilising standard facilities by telecommunications service providers by way of technical gadgets and there was no human intervention for transmitting data through such data links, same did not involve technical services and therefore, assessee was not liable for tax deduction at source under section 194J.



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02. Whether the connectivity charges paid to foreign telecommunications operators be termed as FTS?

- a. Bharti Airtel Ltd. [2016] 67 taxmann.com 223 (Del Trib.)

 The services that can be said to be of technical nature are the special skills and knowledge related to technical field, which are required for the provisions of such services. An element of human intervention is required for provision of such services. The services provided by machines and robot do not fall within the ambit of technical services as under section 9(1) (vii). Thus, it held that Inter-connect Usage Charges paid by the assessee, a telecommunication service provider, to Foreign Telecommunications Operators in connection with its International Long Distance telecommunications service business, was neither FTS nor royalty.
- b. Bharat Sanchar Nigam Ltd. [2017] 87 taxmann.com 152 (Delhi-Trib.) It was held that the payment of IUC charges as per the agreement between assessee and foreign company clearly showed that a standard facility for availing interconnectivity services was availed by assessee. The said services did not require any human intervention. It was, therefore, held that payment for IUC Charges was not chargeable to tax in India in the hands of nonresident recipients, and hence TDS was not deductible as per provisions of section 195.
- c. Clearwater Technology Services Pvt. Ltd. [2012] 139 ITD 479 (Bang Trib.) Payments made to foreign telecommunications company for voice charges are in form of service charges and such service charges are not in the nature of managerial, consultancy or technical services i.e., fees for technical services and accordingly, the same would not be chargeable to tax in India in the absence of a PE of telecommunications company in India.
- d. Interroute Communications Ltd. [2016] 68 taxmann.com 160 (Mum Trib.) Sum received by assessee, a UK based company, from Indian telecommunications operators towards use of Virtual Voice Network (VVN), i.e., facility provided by assessee to connect calls to end operators through assessee's port, could not be treated as royalty or fee for technical services in article 13 of India-UK DTAA. The Tribunal held that the assessee may charge a fixed amount to cover its costs in employing enhanced capacity so as not to incur losses when this capacity is not used, but what the customer is paying for is a service and not for the use of equipment involved in additional capacity, for any scientific work, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. It cannot therefore, be taxed as royalty under Article 13 of the India-UK tax treaty. Further, there is no transfer of technology here, and in that sense technical services are not available.

Similar views have been taken in the following cases:

- Wipro Ltd. [(2004) 1 SOT 758]
- Infosys Technologies Ltd. [(2011) 45 SOT 157]



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03. Whether the consideration paid to telecommunications operators should be considered as royalty or not?

- a. Dell International Services India (P.) Ltd., In re [2009] 305 ITR 37 (AAR) Applicant, an Indian company, has entered into an agreement with BT America (BTA), an American company. Under this, BTA provides applicant with two-way transmission of voice and data through telecommunications bandwidth for which fixed monthly recurring charge for circuit between America and Ireland and for circuit between Ireland and India is payable to BTA. The AAR held that by availing facility provided by BTA through its network/ circuits, there is no usage of equipment by applicant. It is a case of BTA utilising its own network and providing a service that enables applicant to transmit voice and data through telecommunications bandwidth. Therefore, payment made by applicant to BTA cannot be taxed as "royalty" under Explanation 2 to clause (vi) of section 9(1) or under article 12 of Treaty. Further, it would also not be taxable as "fee for included services" within the meaning of article 12(4).
- b. WNS North America Inc. [2014] 66 SOT 33 (Mumbai-Trib.)

 The Tribunal held that where an arrangement for international lease line connectivity charges did not allow WNS India a right to use any industrial, commercial or scientific equipment, payment made for lease line charges was not in nature of royalty as per Indo USA-DTAA.
- c. B4U International Holdings Ltd. [2012] 21 taxmann.com 529 (Mumbai)

 The Tribunal examined the taxability of transponder hire charges paid to a foreign entity in India. The Tribunal placed its reliance on the Delhi High Court decision of Asia Satellite Communications Co. Ltd. and held that payment cannot be regarded as royalty. The Tribunal also held that the amendments to the definition of "royalty" under the ITA would not have any impact on its decision, as there are no changes in the defination of royalty in the India-USA Tax treaty.
- d. Verizon Communications Singapore Pte. Ltd. [(2013) 39 taxmann.com 70] The consideration received by the non-resident taxpayer from the Indian customers for provision of bandwidth/telecommunications services outside India was for the "use of, or the right to use equipment" and therefore, royalty under Section 9(1)(vi) of the ITA. Alternatively, the payments can also be considered for the use of process provided by the taxpayer and therefore, royalty under the ITA. The High Court further held that the definition of "royalty" under the India-Singapore tax treaty and the ITA are in pari-materia and therefore, the consideration would be royalty under Article12 (3) of the tax treaty.
- e. Vodafone South Ltd. [2015] 53 taxmann.com 441 (Bangalore-Trib.)

 The Bangalore Tribunal held that where assessee-telecommunications company provided international long distance services to its subscribers and it paid consideration to non-resident telecommunications operators for providing international carriage and connectivity services, same would fall within ambit of royalty under section 9(1)(vi).



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f. New Skies Satellite BV [2016] 382 ITR 114 (Del HC)

Unless DTAA is amended jointly by both parties to incorporate income from data transmission services as partaking of nature of royalty, or amend definition in a manner so that such income automatically becomes royalty, Finance Act, 2012 which inserted Explanations 4, 5 and 6 to section 9(1)(vi) by itself would not affect meaning of term "royalties" as mentioned in article 12 of India-Thailand DTAA. The Supreme Court has accepted the Special Leave Petition filed by the Revenue against the said decision.

- g. Geo Connect Ltd. [2017] 88 taxmann.com 758 (Delhi-Trib.) Assessee paid International Private Leased Circuit (IPLC) charges to two American companies for use of dedicated private bandwidth in underwater sea cable. In view of fact that undersea cable for providing dedicated bandwidth to assessee was installed beyond the territory of India and no operations were carried out by non-residents in India, section 9(1) (i) was not attracted and payment made by assessee was not chargeable in hands of non-resident companies in India. Further, as American company only agreed for rendering services of transmission of call data and its effective management and there was no agreement for use or right to use any industrial, commercial or scientific equipment or patentable process between non-resident and assessee for use of dedicated private bandwidth in underwater sea cable, consideration paid to American company would not fall under term "royalty" under section 9(1) (vi). As in call connectivity and transmission from end of Indian territory at Mumbai to termination of call in USA, there was no technical knowledge available to assessee, payment in question could not be termed as fee for technical services.
- h. Cognizant Technology Solutions India (P.) Ltd. [2014] 47 taxmann.com 409 (Chennai-Trib.)

Assessee was in receipt of International Private Leased Circuits (IPLC) bandwidth service for Internet access, business, data exchange, video conferencing, and other telecommunication facilities to enable dedicated high speed connectivity from M/s.Sprint USA (a US based company). The Tribunal held that payment for use of "process" provided to assessee, whereby through assured bandwidth, customer was guaranteed transmission of data and voice, was "royalty" as per section 9(1) (vi).

Spectrum fees

01. Spectrum fees is a revenue expenditure and not capital in nature

a. Vodafone Essar Digilink Ltd [2018] 92 taxmann.com 234 (Delhi-Trib.) When assessee claimed deduction of spectrum charges on quarterly basis as a percentage of revenue, it was held that to be covered under section 35ABB, it is sine qua non that the expenditure for obtaining licence must be of capital nature at the first instance. Further, when payment is not meant for obtaining a licence to use spectrum, but for the actual use of it on regular basis, it is in the nature of a revenue expenditure eligible for deduction. Thus, it cannot be construed as a capital expenditure and thereby, goes out of purview of section 35ABB and shall be allowed as a business expenditure.



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- b. Evergrowth Telecommunications Ltd [2013] 29 taxmann.com 273 (Bombay) Remittance was made by the assessee to 'J' as an operating license fee for the year under consideration. Consequently, no enduring benefit is received by the assessee so as to spread the expenditure beyond the period of one year in which the expenditure is incurred. Thus, Section 35ABB would have no application in the instant case and accordingly, the said expenditure was allowed as a revenue expenditure.
- c. Fascel Limited [2009] 34 SOT 8 (Delhi) (URO) It was observed by the Tribunal from the licence agreement that licence fee paid to operate telecommunication services and royalty payable to Wireless Planning Commission were totally different. Therefore, provisions of section 35ABB were not under royalty payable. It was also noted that expenditure was incurred by assessee as a part of network operation expenditure on basis of period for which facility was used. Therefore, the said expenditure could not be said to bring in any benefit of enduring nature.

Payments for international connectivity through use of submarine cable systems a. Dishnet Wireless Limited [2012] 24 taxmann.com 298 (AAR)
Where the payments were made to the foreign company for ac

Where the payments were made to the foreign company for acquisition of the cable capacity, it was held that as per the clarificatory amendment to Section 9(1) (vi) of the Income Tax Act (ITA), such payments made were for a right to use a process and a right to use commercial or scientific equipment and would therefore be taxable in India as "royalty" under the ITA.

b. Flag Telecommunications Group Ltd. [2015] 54 taxmann.com 154 (Mumbai-Trib.)

Consideration was received by the foreign company towards transfer of the capacity in the undersea cable system for providing telecommunication link to the Indian company. The Tribunal held that the Indian company not only had an exclusive ownership over the capacity, but also the exclusive right to use the capacity. The Indian company could assign or transfer or sell such capacity to any other party. Accordingly, there was no assignment of "right to use", but it was "sale of capacity" in the cable system.

As such payment was on account of sale, and it would constitute as business income. Further, the sale was concluded outside India on principal-to-principal basis, thus no taxable income would accrue or arise in India.

Further, standby maintenance charges paid by the Indian company was in the form of fixed annual charge and there was no rendering of any service. Therefore, such receipt is not taxable as Fees for Technical Services (FTS) under Section 9(1) (vii) of the ITA.

c. Flag Telecommunications Group Ltd. [2015] 59 taxmann.com 411 (Mumbai-Trib.)

Fixed annual charge received by the assessee from VSNL (which had bought capacity in assessee's Flag Cable System) for arranging standby maintenance services as and when required, would not be chargeable as fees for technical services under section 9(1)(vii).

Where the assessee used spare capacity in its cable system to provide restoration of traffic to Indian customers of other cable operators in event of disruption in traffic on their cable system, amount received by it for such activity would be deemed to be business income arising in India to the extent its cable passed through territorial waters of India.



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Withholding tax issues for the margin allowed by telecommunications operators to the distributors

Favourable Judicial Precedents

- a. Vodafone Cellular Ltd [2017] 88 taxmann.com 917 (Pune-Trib.)
 Sale of SIM cards/recharge coupons at discounted rate to distributors is not commission and, therefore, not liable to TDS provisions under section 194H.
- b. Bharti Airtel Limited [2014] (52 Taxmann.com 31) (Kar HC) The assessee sold SIM cards/ RCVs at the maximum retail price (MRP) less discount to the distributors. Thus, discount being profit margin given to the distributors was to be realised by them on resale of such SIM cards to the ultimate customers.

It was observed that the income of the distributor was the difference between sale price and MRP (as fixed by the service provider), which accrues to them only when they sell the services to the ultimate customers and not when they purchase the right to service. Thus, at the time of sale of a prepaid card by the assessee, no income had accrued to the distributor that was chargeable to tax.

Accordingly, High Court held that telecommunication service provider is not liable to TDS under section 194H on the amount of discount given to the distributor.

c. Bharti Hexacom Ltd. [2016] (68 taxmann.com 388) (Jaipur Trib.)

The assessee, a telecommunication service provider, sold its prepaid start up packs and recharge vouchers to distributors/dealers on less than fixed MRP on said products. Assessing Officer held that the price difference between the MRP and the dealers price was the commission paid by the assessee to its distributors, and hence the assessee was liable to deduct tax at source under section 194H on the commission payment to its distributors. The Tribunal relied on the decision of Tata Teleservices Ltd. v. ITO (IT Appeal No. 309 (JP) of 2012, dated 13-3-2015] and held that where relationship between assessee and its distributors in connection with sale of start-up pack and recharge vouchers was on principal-to-principal basis, discount given to distributors on such transaction would not amount to commission in terms of section 194H.

Similar view is taken by the following courts:

- d. Vodafone Essar Gujarat Ltd [2015] 60 taxmann.com 214 (Ahmedabad-Trib.)
- e. Bharti Hexacom Ltd. [2016] 68 taxmann.com 357 (Delhi-Trib.)

Following are the judicial precedents with a contrary view:

f. Idea Cellular Limited [2010] (325 ITR 148) (Del) The essence of the service provided by the distributor is not a sale of any product or goods. However, the distributors are always acting for and on behalf of the assessee. Commission paid by cellular telephone company to distributors on sale of prepaid sim cards is liable to TDS under section 194H.



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g. Bharati Cellular Limited [2011] 12 taxmann.com 30 (Cal)

Franchisees of the assessee sold SIM cards and prepaid coupons to retailers and had made payment of sale proceeds to assessee after deducting discount. There was principal agent relationship between assessee and franchisees, and therefore receipt of discount by franchisee was in real sense commission paid to franchisees, as per provisions of section 194H.

h. Cellular Mobile Telecommunications Services [2013] 31 taxmann.com 188 (Chennai Trib.)

Discount offered by cellular company to distributors on payments for recharge coupons, which were eventually sold to subscribers at listed price, is commission and, thus, liable to TDS under section 194H.

 i. Hutchison Telecommunications East Ltd. [2015] 59 taxmann.com 176 (Calcutta HC)

Discount allowed by assessee to its distributors in respect of starter packs and recharge coupons for its prepaid mobile service amounted to payment of commission or brokerage that required deduction of tax at source under section 194H.

Similar view is taken by the following courts:

- j. Bharati Airtel Ltd [2013] 40 taxmann.com 46 (Cochin-Trib.)
- k. Vodafone Essar Cellular Ltd. [2010] 194 Taxman 518 (Kerala)
- I. Tata Teleservices Ltd. [2018] 93 taxmann.com 22 (Delhi-Trib.)

Miscellaneous issues

a. Sabdhagiri Telecom [TS-720-HC -2018] [Madras HC]

It was held that where the assessee is operating telephone exchanges and providing basic telecommunication services to its BSNL customers, merely since the assessee is collecting commission charges, the benefit of section 80IA (4)(ii) cannot be denied. Further, the Hon'ble HC also referred to the wide and inclusive "telecommunication service" as per the TRAI rules, which includes services of any description made available to users by means of any transmission or reception of signs, signals, etc.

b. Reach Network India (P.) Ltd. [2017] 166 ITD 461 (Mumbai-Trib.) Assessee was engaged in business of wholesale procurement and sale of bandwidth to retail ISPs and corporate users and it did not provide any bandwidth network and internet services.

Section 80-IA was introduced with a specific purpose to give impetus to infrastructure of the country in various fields, including the telecommunication services. Deduction was allowed for broadband network to the undertakings, which had started providing telecommunications services. The assessee was granted a licence by the competent authority to provide broadband services and to work as ISP. Having a licence of a particular product/facility is different from the actual business of an assessee. The assessee had not provided broadband network/Internet services. The Tribunal held that income earned by the assessee on account of sale of bandwidth was not derived from the eligible business and was not entitled to claim deduction in that regard. Accordingly, its claim for deduction under section 80-IA (4) (ii) was rejected.



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Indirect tax issue Decision

c. Vodafone Mobile Services Ltd [TS-764-HC-2018](DEL)

The Hon'ble Delhi HC allowed deduction under section 80IA(2) to Vodafone Mobile Communications Ltd on income from sharing fibre cables and cell sites.

Miscellaneous issues

Shyam Telelink Limited [TS-704-HC-2018] (DEL)

The Hon'ble HC in this case held that assessee's mode of recognising revenue on prepaid cards on the basis of actual usage and carrying forward unutilised amount outstanding on the prepaid cards to the next year is in consonance with the matching principles for revenue recognition.

Applicability of service tax on sim card distribution

Sale of sim cards

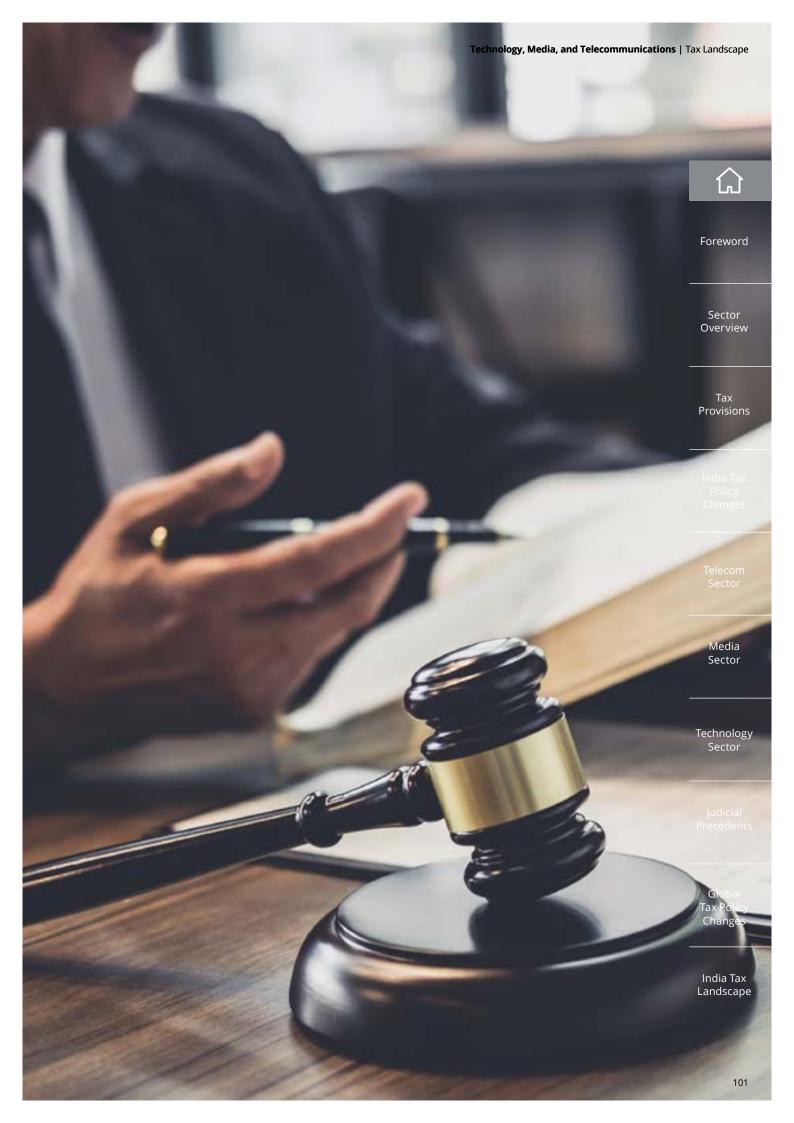
There has been a long drawn dispute between the revenue and the telecommunications companies with respect to applicability of indirect taxes on the sim cards. The VAT vs. service tax battle was prominent in sale of sim cards. The distributors of the sim card discharged VAT treating distribution of sim cards as sale of goods, since a sim card is a movable item and would qualify as "goods". The service tax authorities challenged this view and sought service tax considering the same as telecommunications service.

a. Idea Mobile Communication Limited vs. CCE&C, Cochin [2011 (8) TMI 3. The Supreme court resolved the dispute by concurring to the view adopted by the service tax authorities, which emphasised on the principal intent of buying a sim card and held that, the telecommunications is liable to pay service tax on the MRP of sim card. The GST law contains a specific provision in this regard and the dispute of sim card transaction that occurred in past may not happen in the GST regime.

Services by sim card distributors

Once the above dispute was resolved, another dispute came up. It was related to the applicability of service tax on the agency commission received by a distributor. The telecommunications sector responded that since the tax is paid on the entire MRP of the sim card, service tax payment again on the agency commission would lead to double taxation.

b. Antulal & Sons vs CCE, Raipur [2016 (12) TMI 1275 – CESTAT New Delhi]. The Tribunal agreed with the view of the industry that once the service tax is paid on MRP of sim card, tax on agency commission would lead to double taxation. Honouring the observations of the Courts, services by agents/distributors to the telecommunications were subsequently exempted from payment of service tax. However, under the GST regime, in absence of any explicit exemption, GST would be payable on the commission earned by the agents/distributors. This would also entitle the distributors to avail ITC in respect of the procurements made by them.



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Advertising and broadcasting

Advertising on television channels

- 01. Payments made to advertising agencies to secure more business is in the nature of commission subject to withholding under section 194H of the Act
 - a. Prasar Bharti Doordarshan Kendra v. Commissioner of Income Tax, Thiruvananthapuram [2018] 92 taxmann.com 11 (SC)

Payment of commission in the form of discount paid to various advertising agencies is subject to withholding at source under section 194H of the Act (which applies to payment in the nature of commission). This was on the basis that the contract between the assesse (a government entity engaged into telecast of news, sports, entertainment telecast, etc.) and the advertising agencies was on a principal-to-agent basis and not principal to principal. Further, the terms of agreement indicate that both the parties intended that the amount paid to the agencies should be by way of commission.

Trade discount given by media houses to the advertising agencies for booking or procuring or canvassing advertisements is not in the nature of commission in the absence principal agency relationship

01. Jagran Prakash Limited v. DCIT [2012] 21 taxmann.489 (Allahabad HC) Trade discount given by newspaper agency (tax payer media company) to advertising agencies is not in the nature of "commission" referred under section 194H of the Act. It is because the relationship between the media company and the advertising agency was not in the nature of principal-agent.

Subsequent to the above decision, CBDT vide **Circular No. 5/2016** has clarified that the applicability of TDS on the following types of payments involved in the advertising business as under:

- Advertisers to advertising agency TDS applicable under section 194C, Circular No 715 dated 8 August 1995;
- Advertising agency to the television channel/newspaper company (including print, television, radio media company) – TDS will not be applicable due to principal-to-principal relationship;
- Payment by television channels/newspaper companies to advertising agency for procuring or canvassing for advertisements – TDS will not be applicable due to principal-to-principal relationship.

Similar position has been held in the following case laws:

- Joint Commissioner of Income-tax (TDS)-2(3), Mumbai v. Bharat Business Channels Ltd [2018] 92 taxmann.com 216 (Mumbai Tribunal)-trade discount granted to principal distributor of Direct to Home (DTH) services.
- Tata Sky Ltd, Mumbai v ACIT (Tds) Rg. 3(1) [2018] (6926/Mum/2012) (Mumbai ITAT).



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Payment towards "right to distribute" contents of television channels through own DTH Network (ultimately to be viewed by users) 01. Amount paid by the distributors of television channels for further dissemination of content (on its on DTH network) is in the nature of "royalty" and not "works contract"

a. Dish TV India Ltd v. Assistant Commissioner of Income tax (TDS) [2016] 67 taxmann.com 282 (Delhi ITAT)

Assessee had obtained exclusive right to distribute contents of television channels. The ITAT further observed that the taxpayer did not make any payment to television channels for telecasting, rather it telecasted television programmes on its own. Hence, the ITAT held that the payment made for distribution of content is in the nature of royalty defined under Explanation 2(v) to section 9(1)(vi) of the Act and tax is deductible under section 194J of the Act (and not under section 194C of the Act).

Sale/distribution of advertisement time in India by a foreign company Sale of advertisement time in India by a foreign entity does not create a Permanent Establishment of the entity in India

01. International Global Networks BV v. ADIT, International Taxation, Range **4(1)** [2017] 84 taxmann.com 188 (Mumbai ITAT)

The assessee, a Netherlands based company, was a wholly owned subsidiary of Satellite Television Asia Region Limited (STAR Ltd), Hong Kong. The taxpayer was granted exclusive rights for sale of advertising time, in India and had entered in to an agreement with an Indian entity (SIPL) for procuring commission from Indian advertisers. SIPL was treated as a conduit and SIPL was held as PE of STAR Ltd, Hong Kong.

The Hon'ble ITAT observed that SIPL carried out its activities in ordinary course of business and was not wholly and exclusively devoted to the assesse. Also, the payment to SIPL was at arm's length. Consequently, SIPL was held to be an independent agent under Article 5(6) of the DTAA between India and Netherland. In the absence of PE in India, no part of the revenue was attributable to India.

The Supreme court has recently granted a special leave petition against order of Bombay High Court in case of Director of Income- tax (IT)-II v. B4U International Holdings Ltd (SC) (2016) 71 taxmann.com 182, where the Indian company was not held to be a permanent establishment on the similar facts.

Revenue from distribution of paid channel to various cable operators (ultimately Indian customers) is not taxable in the absence of PE

01. ADDIT (IT) -2(2)/2(1) v. Taj TV Ltd [2016] 72 taxmann.com 143 (Mumbai ITAT) The assessee, a Mauritius based company was engaged in the business of broadcasting sports channel and entered into a distribution agreement with its Indian subsidiary for distribution of paid channels to various cable operators and ultimately to consumers in India.

The Hon'ble Bombay HC held that the distribution revenue received from subsidiary is not taxable since the entire arrangement qua distribution was on a principal-to-principal basis. Indian subsidiary had obtained distribution right for itself and subsequently entered independent contracts.



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Band placement fees

- 01. Channel placement fees paid by the broadcasters to multi-system operators/cable operators for placing their channels on a particular band is subject to withholding as applicable to works contract under section 194C of the Act
 - a. Commissioner of Income–tax v. TDS-2, Mumbai v UTV Entertainment Television Ltd [2017] 88 taxmann.com 214 (Bombay HC)
 - b. Commissioner of Income–tax, TDS-2, Mumbai v. Zee Entertainment Enterprises Ltd [2018] 92 taxmann.com 30 (Bombay HC)

Payment of transponder fees

Transponder fees paid to a non-resident is taxable under the Act in enlarged definition of royalty [under section 9(1) (vi)]. However, the same is not taxable as "royalty" under most Indian tax treaties.

- 01. United Home Entertainment Private Limited v. The Dy. Commissioner of Income tax [2018] (ITA No 1289/Mum/2016) (Mumbai ITAT) Not taxable as royalty in terms of Article 12 of India-USA DTAA
- 02. Independent News Service (P.) Ltd v. Income tax Officer (IT) Ward-2(1)(2) [2018] 90 taxmann.com 163 (Delhi Tribunal) Not taxable as royalty in terms of Article 12 of India-USA DTA
- 03. Taj TV Limited v. Additional Director of Income-tax (International Taxation), Range -2, Mumbai [2017] (77 taxmann.com 355) (Mumbai ITAT) – Not taxable as royalty in terms of Article 12 of India-USA DTA
- 04. New Delhi Television Ltd. v. Assistant Commissioner of Income-tax, Circle 13(1), New Delhi [2017] (83 taxmann.com 282) (Delhi Tribunal) Not taxable as royalty in terms of Article 12 of India-USA DTA
- 05. Director of Income –tax v. New Skies Satellite B.V (High Court) (2016) (68 taxmann.com 8) Not taxable under India-Thailand DTAA and SLP has been granted by SC against the decision of High Court

Contrary view:

- a. Verizon Communications Singapore Pte Ltd v Income tax Officer, International Taxation -1 [2013] 39 taxmann.com 70 (Madras HC)

 The Hon'ble Madras HC held that bandwidth payments made by Indian customers to assessee for International Private Leased Circuit (IPLC) for end-to-end internet connectivity was taxable as royalty received for use of "equipment" and for the use of "process" under the section 9(1)(vi) and article 12(3) of the India-Singapore DTAA.
- b. Viacom 18 Media (P.) Ltd v Assistant Director of Income-tax (International Taxation) -2(2), Mumbai [2014] 44 taxmann.com1 (Mumbai Tribunal)

Payment for purchase of advertisement space (for digital advertisements)

Payment to a non-resident for purchase of advertisement space for resale to advertisers in India constitute royalty as per section 9(1)(vi) of the Act and is not subject to equalisation levy

O1. Google India [2018] 93 taxmann.com 183 (Bangalore Tribunal)Google India Private Limited (GIPL) is engaged in the business of providing information technology (IT) and IT enabled services (ITES) to its group companies. GIPL also acts as a distributor for AdWords programmes in India. GIPL made payment to Google Ireland Limited (GIL) towards purchase of advertisement space for resale to Indian advertisers and for certain post sale services (interalia including trademarks, IPRs, brand features, derivative works, and other intangibles owned by GIPL).



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The Bangalore ITAT had adjudicated that the payments made by GIL by GIPL was in the nature of royalty and not equalisation levy. Accordingly, ITAT upheld that Indian company (GIPL) was required to withhold tax under section 195 of the Act.

The ITAT clarified that equalisation levy is only charged on consideration for specified services and not for the services provided in the present case (i.e., use of IPR, copyright, etc.). Therefore, the ITAT held that the introduction of equalisation levy would not convert the nature of payment made by GIPL to GIL.

Payment towards installation of set top box

Installation charges paid for installation of set top boxes is in the nature of a "works contract" and is subject to TDS under section 194C of the Act. In the absence of any technical expertise required, the payment is not in the nature of fees for technical services for the purposes of section 194J of the Act

- 01. Tata Sky Ltd.-[2018] 99 taxmann.com 272 (Mumbai-Trib.)
- **02. Joint Commissioner of Income- tax (TDS) -2 (3), Mumbai v. Bharat Business Channels Ltd.** [2018] 92 taxmann.com 216 (Mumbai ITAT)

Set up box sold at discounted price

- 01. Discount offered on sale of set-up boxes / rechargeable coupons cannot be treated as commission and hence no tax is to be withheld u/s 194H.
 - **01. Tata Sky Ltd.-**[2018] 99 taxmann.com 272 (Mumbai-Trib.)
 Where assessee sold set top box (STB) and recharge coupon vouchers to distributors at a discounted rate, this discount so offered could not be considered as commission and, hence, not liable for deduction of tax at source under provisions of section 194H.

Films

Line producer fees (locational services) paid to a non-resident for the services rendered at foreign location

- 01. Payments to non-resident towards line production services (arranging local crew, transport, working meals, location, equipments, etc.) provided outside India are not taxable in India in the absence of PE
 - a. Yash Raj Films (P.) Ltd v Income- tax Officer, (International Taxation)-2(2), Mumbai [2012] (28 taxmann.com 247) (Mumbai ITAT) In the aforesaid case, the Mumbai Tribunal upheld that services by a non-resident line producer for arranging logistics for shooting of different films outside India were in the nature of commercial services. Hence, the amount received for line production services constitutes business profit of service provider, which was held as not taxable in India in absence of any PE in India.

It is further held that such services does not fall under the purview of technical, managerial or consultancy services and therefore, is not taxable as fees for technical services.

b. The aforesaid view has been also followed in the case of Endemol India Private Limited, [2013] 40 taxmann.com 340 Mumbai (AAR) Line producer's fee is in the nature of business income and not fees for technical service. In the absence of PE, no income is subject to tax in India, and therefore no requirement of withholding tax.

Similar position has been held in the following case laws:

 Endemol South Africa (Proprietary) Limited v. Deputy Commissioner of Income tax [2018] (98 taxmann.com 227) (Mumbai Tribunal)



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Deductibility of cost of production paid for producing film in Hindi

Production of motion/cinematography films is in the nature of "work contract" and not "fees for technical services".

01. Nitin M. Panchamiya v. Additional Commissioner of Income tax [2012] 19 taxmann.com 200 (Mumbai ITAT)

Fees paid for production of films is subject to TDS under section 194C (as a work contract) and not under section 194J (fees for technical services) of the Act. Consequently, it was held that tax was rightly deducted at source under section 194C and disallowance of cost of production under section 40(a)(ia) is not warranted.

Similar preposition is also upheld in the following decision:

02. Alliance Media & Entertainment Ltd v. Income-tax Officer (TDS) 1(1), Mumbai [2017] 79 taxmann.com 114 (Mumbai ITAT)-Payment of production of films is subject TDS under 194C of the Act

Income from sale of music rights

Income from sale of music rights is an independent transaction from the production of films, and hence, the same is taxable in the year of receipt and corresponding expenses are also deductible in the same year. Such income is outside the purview of Rule 9A

01. Suneel Darshan v Income tax Officer [2005] (2 SOT 753) (Mumbai ITAT) The assessee was carrying on the business of production/ distribution, etc. of films that had received entire consideration on sale of music rights in the relevant assessment year. The assessee had not offered the said income for the captioned year and contended that it should be taxable in the year of release of the film (in accordance with Rule 9A).

The Hon'ble Mumbai ITAT held that there is nothing in Rule 9A to suggest that it is applicable to the sale of music rights. Sale of music rights of a film and sale of exhibition rights of the same film are independent of each other. Therefore, the said income will have to be offered on the basis of the charging provisions of the Act (mercantile system of accounting) and the expenditure against the said income should be allowed accordingly.

Deduction of cost of acquisition of distribution right of a feature film (Rule 9B)

Amount paid by the film distributor to the producer towards exclusive film distribution rights is admissible as deduction under Rule 9B of the Income tax rules

01. Commissioner of Income tax v. Prakash Pictures [2003] 127 taxman. 654 (Bombay HC)

Assesse is a firm engaged in the business of distribution of films. The assesse had entered into an agreement with a producer for acquiring distribution rights on commission basis with a minimum guarantee payment. Later, the assesse also paid for modified agreement for acquiring rights in profits.

The Hon'ble high court held that the producer has the entire rights in the film, the said rights can be given either on advance basis or minimum guarantee fees basis and the same would be covered by the rule 9B of the Income tax rules, and hence deductible. Amount paid to the producer for clearing its right in overflow of profits over unexpired period of old contract was to be allowed in proportion to the revenue over the tenure of contract.



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Consideration for acquiring rights of distribution of cinematographic films

Amount received towards distribution of cinematographic films by a non-resident does not qualify under the definition of a "royalty" under the Act. It will qualify as "business income" and is not taxable unless it has PE in India

01. Warner Bros Distributing Inc vs DCIT, Mumbai [2017] (ITA No 7635/Mum/2016) (Mumbai ITAT)

In the instant case, consideration for distribution of cinematography films is specifically excluded from definition of "royalty" under the Act. Further, the ITAT observed that even if the income arises to the non-resident due to business connection in India, the income accruing or arising out of such business connection can only be taxed to the extent of the activities attributed to PE.

ITAT held that the Indian company cannot be construed as an agency PE of the assesse in India, because the Indian company who obtained rights was acting independently. The ITAT considered the decision of the Hon'ble Supreme Court in the case of Ishikawajma Harima Heavy Industries vs Director of Income tax (2007) (158 taxmann.com 259) that income arising to a non-resident cannot be taxed in India in absence of a PE.

The aforesaid position has also been upheld in the following cases:

- ADIT v. Warner Brother Pictures Inc. [2012] 17 taxmann.com 171 (Mumbai ITAT).
- Indo Overseas Films v. Income Tax Officer, International Taxation 1(2), Chennai [2017] 81 taxmann.com 378 (Chennai ITAT).
- Asiavision Home Entertainment (P.) Ltd v. Assistant Commissioner of Income tax, Circle 11(1), Mumbai [2010] (37 SOT 11) (Mumbai ITAT) – No TDS on payment of fees for acquiring film distribution rights and outside the purview of 40(a) of the Act.

Payment for purchase of movie safelight rights (of a permanent nature)

Consideration for purchase of film satellite right is a sale, and it is excluded from the definition from "royalty" under the Act

01. S.P Alaguvel vs DCIT, Chennai [2014] 52 taxmann.com 231 (Madras HC)
The Hon'ble Madras HC held that an acquisition of movie/film satellite right by a
assesse company (into business of media and dealing with movie/film satellite
rights) on assignment basis and reassigning to the channels, is not in the nature
of "royalty" defined under the Act. Rather, it amounts to perpetual transfer of
rights under sale. Consequently, the High Court upheld tax is neither required
to be withheld under section 194J (payment of royalties) nor section 194C
(payment for work).

Reliance was also placed on the jurisdictional High court decision in case of Mrs. K.Bhagyalakshmi v Dy CIT [2014] 221 taxmann.com 225, wherein similar position was upheld.



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Payment for acquiring satellite broadcasting rights of a film

Amount paid for acquiring broadcasting rights is not in the nature of consideration for purchase of films, and is therefore covered under the definition of "royalty" under the Act

01. ACIT, Media Circle-II, Chennai vs Shri Balaji Communications [2013] 30 taxmann.com 100 (Chennai ITAT)

Under the facts of the case before the Chennai ITAT, it was noticed that the assesse had merely acquired satellite broadcasting rights of a movie and did not purchase any cinematographic film. Thus, the complete ownership of satellite right was not transferred. Consequently, the ITAT held that the assesse was required to withhold tax under section 194J of the Act and amount paid for acquiring broadcasting rights was disallowed under section 40(a) (ia) of the Act.

Post production services carried on outside india

Payment of post-production services rendered outside India is not subject to tax in India in the absence of making available the technical knowledge, experience, etc. under India-Singapore DTAA

01. Red Chillies Entertainment Pvt. Ltd vs ACIT (TDS) [2017](ITA No 6655/Mum/2014) (ITAT Mumbai)

The Mumbai ITAT held that payment for post-production services to a Singapore based company is not subject to TDS under Article 12 of the India-Singapore DTAA in the absence of make available technical knowledge or skill or knowhow. Further, the ITAT observed that the Singapore entity carried on post-production work outside India and had no PE in India and hence, the same was not be taxed as per Article 7 of the India-Singapore DTAA.

Live streaming

Payment for live telecasting/ broadcasting rights

The payment for live telecast of horse race is neither for transfer of 'copyright' nor 'scientific work' and therefore it cannot be termed as 'royalty'

01. Commissioner of Income tax IV v. Delhi Race Club (1940) Ltd [2014] 51 taxmann.com 550 (Delhi HC)

Payment for a live telecast does not have a "copyright" and it cannot be termed as a payment for a scientific work. Thus, the said payment was held as not in the nature of "royalty" under section 194J of the Act and hence, TDS under section 194J is not attracted. The Hon'ble Court relied on the decision of **ESPN Star Sports vs Global Broadcast News Ltd (2008) (38) PTC 477,** wherein the Court had held that there is a distinction between broadcast rights and copyright rights. Therefore, the broadcast right or the live coverage does not have a "copyright".

Similar positions were taken in the following case laws:

- Nimbus Communications Limited [2013] 32 taxmann.com 53 (Mumbai Tribunal)
- Neo Sports Broadcast Private Limited [2011] 15 taxmann.com 175 (Mumbai Tribunal)

TDS applicability on reimbursement in absence of privity of contract

Where the assessee has no privity of contract with the service provider, no tax is required to be withheld, as the same can be considered as purely in the nature of reimbursement.

Organising Committee Hero Honda FIH World Cup [TS-660-SC-2018]

The Hon'ble Supreme Court has dismissed revenue's SLP holding that no tax was deductible under section 195 of the Act on reimbursements made, where the assessee had no privity of contract with the service provider.



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Sponsorship

Taxability of sponsorship fees paid to a non-resident earned by a non-resident

Income earned by a foreign company from sponsorship revenue not to be taxable as "royalty"

01. Director of Income-tax vs Sahara India Financial Corporation Ltd [2010] 189 taxmann.102 (Delhi HC)

The assessee had entered into an agreement with IMG Canada. As per the agreement that IMG was to provide to the assesssee "the title sponsorship" benefits in connection with the cricket tournaments. The agreement provided that all the matches and tournaments would be referred to as "Sahara Cup" and the Sahara name and logo would be displayed at both ends of the cricket ground.

The Hon'ble High Court held that the sponsorship fees paid by the assesse to a non-resident is not "royalty" because it is not for the payment of "any copyright" as referred under Article 13(3) of the India-Canada DTAA.

Similar positions were taken in the following case laws:

- Hero Motorcorp Limited v. Additional Commissioner of Income tax, Range -12, New Delhi [2013] 36 taxmann.com 103 (Delhi Tribunal)
- Golf In Dubai [2008] 174. Taxmann 480 (AAR)

Hosting of an international event in india

PE of a non-resident having complete control of the circuit (where the races were conducted in india) during the period of race (three days) The grant of rights related to right to host, stage and promote event in India create a PE in India, if the full control of/access to such event is retained by a non-resident and it is irrespective of the duration of/period of access to such event.

01. Formula One World Championship Ltd v Commissioner of Income tax, (International Taxation)-3 Delhi [2017] 80 taxmann.com 347 (Supreme Court) Under the instant case, the assesse, a UK resident company (FOWC) had entered into an agreement for a race promotion contract. Under the said contract, Jaypee Sports (India) was granted the right to host, stage, and promote Formula One (F1) Grand Prix of India event for a consideration.

The Hon'ble Supreme Court in this case held that the circuit (where the races were conducted) constituted a fixed place PE of the assessee in India. The fixed place in form of physical location i.e., Buddh International circuit was at the disposal of assessee for the conduct of the business. It was upheld that the High Court had rightly held that the assessee had made their earning in India through the said track over which they had complete control during the period of race. Therefore, the taxable event had taken place in India even if the period was only for three days (which was less than the sufficient duration to establish a fixed place PE in India).



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Sports persons/associations

Taxability of fee paid (prize money, administrative fee) to a foreign team for participating in a cricket match in India

Taxability of fees paid to umpires/ match referee for participating in a match in India The amount paid to foreign team for participation in match in India is deemed to accrue or arise in India and liable for tax withholding at source (payment to non-resident sport persons/sports association) under section 194E read with 115BBA of the Act

Umpires and referees are not sports persons or an athlete and hence, not subject to tax TDS under 194J of the Act

01. INDCOM v. Commissioner of Income tax (TDS), Kolkata [2011] (335 ITR 147) (Calcutta HC)

The ITAT held that the amount paid to foreign team for participation in a match in India, whether a prize money or towards administrative expenses, is income deemed to accrue or arise in India. In the absence of any provision in the relevant DTAA, the income earned by sports person for participating in a cricket match in India is taxable in India under section 115BBA (tax on non-resident sports person/association) read with section 194E (withholding at source on such income) of the Act.

Further, it was held that the umpires and match referees can be described as professional or technical persons and therefore, TDS is deducted under section 194] (payment of fees for technical fees) while making payment to these parties.

Similar position was taken in the following case laws:

02. International Merchandising Corporation v. Deputy Commissioner of Income tax- Circle1 (2), New Delhi [2015] 57 taxmann.com179 (Delhi ITAT)-payment made to a non resident institution was held to be subject to tax deduction at source under section 194E of the Act.

Agent of a nonresident liable to tax on income directly arising in India 01. Director of Income tax (International taxation) v. Board of Control for Cricketing Sri Lanka [2018] 97 taxmann.com 600 (Calcutta HC) International cricket council chose India, Pakistan, and Sri Lanka to co-host World Cup 1996 and a joint management committee Pak-Indo-Lanka (PILCOM) was formed to conduct the tournament. PILCOM paid guarantee money to eleven cricket association and the ITO (TDS) held that TDS ought to be deducted under section 194E on payment to these boards. While the AO had made an assessment of income u/s. 147 for all the cricket boards through PILCOM, ITAT had quashed the same and had held that PILCOM could not be held liable as agent under section 163 as the income had accrued in India and it could not be said to be deemed to have accrued in India.

The Hon'ble HC held that each of the foreign cricket board could be said as a non-resident person and PILCOM could be said to have been their agent. Section 160 declared such an agent for the income of a non-resident specified in Section 9(1) to be a representative assessee. The representative assessee represents consists both direct and indirect income earned through a business connection by the non-resident. Further, the HC clarified that though the short title to section 9 describes the income as deemed to accrue or arise in India, use of this title does not absolve the representative assessee of the duty to account for the income that has been directly earned in India. Thus, PILCOM being an agent of the foreign cricket board is liable to tax in India on the income directly earned by the foreign cricket board in India.



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Print media

Additional depreciation on machines used for printing of news papers

- 01. Printing of newspapers will amount to a manufacture or production for the purposes of claiming an additional depreciation under section 32(1) (iia) of the Act on the machinery installed
 - a. M/S Rajasthan Patrikia Ltd v. ACIT [2015] (ITA No 187/JP/2014) (ITAT Jaipur) In this case, the ITAT upheld that installation of machinery for the purposes of printing and publishing is eligible for additional depreciation under section 32 (1) (iia) of the Act.

In response to the arguments of the lower authorities that simply printing of newspapers cannot be termed as "manufacture or production", the ITAT held that newspapers and periodicals are distinct commodities than paper, printing ink and other ingredients are used therein. Given that a new commercial product comes into existence, the process involved for such transformation amounts to production and manufacture.

Depreciation on hoardings

Hoardings are temporary structure eligible for depreciation @ 100%

01. DCIT v M/s One Ad Display Pvt. Ltd [2017] (ITA No 1373/Kol/2015) (Kolkata ITAT)

The Hon'ble Kolkata ITAT held that depreciation at the rate of 100% on hoardings was treated as temporary structures as against the treatment given by the AO as plant and machinery allowing depreciation at the rate of 15%.

Hoardings treated as permanent structure and depreciation allowed @ 10% on WDV

02. Asian Advertising v Income – tax Officer -12 (3)(4), Mumbai [2016] 68 taxmann.com 139 (Mumbai ITAT)

In the instant case, the hoarding structures erected were permanent and were embedded in building constructed for entities to display their advertisements. Hence, these hoarding structure held at "building" were eligible for depreciation @ 10% instead of 15% (applicable to plant and machinery) as contended by the assesse.

Other issues

Domain registration charges

Rendering of domain registration services is in connection with use of intangible properties, is similar to trademark, and is taxable as "royalty"

01. Godaddy.com LLC vs ACIT [2018] 92 taxmann.com 241 (Delhi ITAT) In the facts of the case, the assesssee company was a limited liability company located in the USA. It was engaged in the business as accredited domain name registrar authorised by ICANN. The assessee filed its return of income declaring the income as web hosting services/on demand sales as "royalty". The department contention was that it is in the nature of "fees for technical services".

The Hon'ble ITAT has held that rendering of services for domain registration is rendering of services in connection with use of an intangible property, which is similar to trademark and therefore, charges received by the assessee for said services is royalty within the meaning of clause (iii) of Explanation 2 to section 9(1)(vi)



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Advertising material

Applicability of GST

Whether supply of printed advertisement material amounts to supply of goods

01. M/S. Macro Media Digital Imaging Private Limited [2018 (6) TMI 519].

The Authority for Advance Ruling - Hyderabad dealt with the taxability of sale of printed advertisement material and held that it was to be treated as supply of goods. The ruling referred to Section 7 of CGST Act, 2017 read with Schedule-II Sl. No. 1(a) of CGST Act, 2017 and observed that manufacturing and sale of digital printed materials based on customers specification, wherein the required material was procured by the applicant and considered as transferring the title in the goods i.e., printed advertisement materials. Therefore, supply of printed advertisement materials amounted to supply of "goods".

Broadcasting

CENVAT credit

Availability of CENVAT credit on telecasting charges for broadcasting entities 01. Chennai M/S. Radaan Media Works (I) Ltd. Versus CCE & ST, Chennai [2018 (6) TMI 201].

The Chennai Tribunal has held that CENVAT credit shall be available on telecast of serials produced, even though telecasting occurred after the production of the serials. It was observed that the telecasting charges paid were used for providing the output service in the nature of sale of space or time for advertisement and hence, assessee could avail the CENVAT credit.

Technology

Income tax issues

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Taxability in case of supplier of software

Payment of software not taxable as royalty

01. Reliance General Insurance Co. Ltd [2018] 97 taxmann.com 350 (Mumbai-Trib.)

It was observed by the ITAT that where the purpose of the license or the transaction is only to restrict the use of the copyrighted product for internal business purpose of the licensee, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. Thus, the amount received by the licensor, its AE from the assessee did not give rise to any royalty income within the meaning of article 12(3) of the India-US DTAA.

02. ZTE Corporation [2017] 77 taxmann.com 304 (Delhi HC)

The High Court observed that the software supplies enabled the use of the hardware sold. Also, without the software, use of hardware was not possible. The mere fact that separate invoicing was done for purchase of software did not imply that it was royalty payment. In such cases, the nomenclature (of license or some other fee) was indeterminate of the true nature, nor is the circumstance that updates of the software are routinely given to the assessee's customers. Thus, it was held that as these facts do not detract from the nature of the transaction, which was supply of software, in the nature of articles or goods, it resulted in a case of sale of copyrighted article and, thus, payment made towards supply of software was not taxable in India as royalty.



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03. Infrasoft Limited [2013] 39 taxmann.com 88 (Delhi HC)

Amount received by the assessee, a non-resident company, for granting license to use its copyrighted software for licensee's own business could not be brought to tax as "royalty" under article 12(3) of India-US DTAA. To qualify as royalty payment, it was necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copyright of a literary, artistic or scientific work. Just because one had the copyrighted article, it does not follow that one had also the copyright to it. As there is no transfer of any right in respect of copyright by the assessee and it is a case of mere transfer of a copyrighted article, the said payment would represent purchase price of an article and cannot be considered as royalty.

04. Vinzas Solutions India (P.) Ltd. [2017] 77 taxmann.com 279 (Madras)

The High Court has held that there is a difference between a transaction of sale of a "copyrighted article" and one of "copyright" itself; provision of section 9(1)(vi) as a whole, would stand attracted in case of latter and not former.

The provisions of section 9(1) (vi) dealing with and defining "royalty" cannot be made applicable to a situation of outright purchase and sale of a product. Explanations 4 and 5 to section 9(1) (vi) have to be read and understood only in that context and cannot be expanded to bring within its fold transaction beyond the realm of the provision.

05. Infotech Enterprises Ltd. [2014] 63 SOT 23 (Hyd. ITAT)

Where software was purchased from Dutch company and after bundling it with its own software, it was sold to its own customers, both in India and abroad, in view of facts that license in respect of software was not obtained by assessee and perpetual license was given directly to end customer by vendor company. Payments made by assessee to Netherlands company would not fall under ambit of "Royalty" under section 9(1) (vi) or as per article 12 of India-Netherlands DTAA.

06. Galatea Ltd. [2016] 67 taxmann.com 190 (Mumbai-Trib.)

The assessee, an Israel company, sold machines and operating software to its customers. In the invoice issued by the assessee, the consideration was mentioned separately for the machine and operating software. Some of the customers deducted tax at source at the rate of 10% from the payments made by them towards operating software and application software, treating the same as "Royalty" under article 12(3) of the Israel tax treaty. However, the assessee was of the view that the aforesaid payments made by the customers did not constitute "Royalty", under the Israel tax treaty and the tax was wrongly withheld by the customers.

The Tribunal held that the amendment made under section 9(1)(vi) by Finance Act, 2012, for extending scope of term "Royalty", shall not be read into provisions of article 12 of India-Israel tax treaty as amendment made in provisions the Act cannot be automatically read into articles of treaty unless corresponding amendment is made in treaty also. Accordingly, the Tribunal held that where the assessee sold to its customers machines and operating software, there was neither transfer of copyright or any rights therein nor was there any situation giving rise to any type of infringement of copyright by customers of assessee. Hence, sales consideration received by assessee would not constitute "Royalty" within meaning of article 12(3) of DTAA between India and Israel.



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07. Reliance Communication Ltd. [2018] 90 taxmann.com 358 (Mumbai-Trib.) The Tribunal held that where consideration paid by assessee to non-resident suppliers for acquiring software was actually made for "copyrighted article" and not for "use of copyright or transfer of right to use of copyright", payment made by assessee to vendors of software could not be taxed as royalty. The Tribunal held that rights of the owner of the IPRs and the rights and duties of purchasers/users are the decisive factors. If the owner retains absolute rights of the IPR's with itself then the payments made by the user will not be defined as royalty. But, if the owner transfers the rights of the property against periodical or one-time payment to the user it will be a case of payment of royalty. Thus, it is the degree of transfer of the rights of IPRs that is very crucial. In the instant case all the agreements stipulate that the assessee would be using the software for "operation of its wireless network only". Thus, it is clear that it was prevented to utilise the software for commercial uses. Restriction on copying the software clearly establishes that the suppliers of the softwares were the sole and exclusive owner of the rights, title, and property in software and the source codes. Agreements clearly mention that copyright would remain with the foreign entities. Also, the copies of the software has to be returned to the vendors upon termination or cancellation of the agreements. Thus, the Tribunal held that the payment was made for the "copyrighted article" and therefore, cannot be taxed as royalty.

Similar view is considered in the case of:

- Nortel Networks Singapore (P.) Ltd [2018] 93 taxmann.com 401 (Delhi-Trib.)
- Hewlett Packard (India) P. Ltd [2006] (5 SOT 660) [Bang ITAT]
- Baan Global BV [2016] 71 taxmann.com 213 (Mumbai-Trib.)
- Intec Billing Ireland [2018] 90 taxmann.com 94 (Mumbai-Trib.)
- First Advantage (P.) Ltd. [2017] 77 taxmann.com 195 (Mumbai-Trib.)
- Visteon Technical & Services Centre (P.) Ltd. [2017] 81 taxmann.com 390 (Chennai-Trib.)
- Black Duck Software Inc. [2017] 86 taxmann.com 62 (Delhi-Trib.)

08. Cognizant Technology Solutions India(P.) Ltd [2018] 100 taxmann.com 464 (Chennai Tribunal)

The assessee company being engaged in the business of software development had made a payment to a Singapore based company for acquiring license of the software. The Hon'ble Tribunal remanded back the matter for fresh disposal since, there was no examination on the real nature of software, whether it was firmware or embedded software or standalone software to opine on the nature of royalty.



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Contrary view:

a. Synopsis International Old Ltd (ITA No. 11 to 15 of 2008 and 17 of 2008) (Karnataka High Court)

The High Court held that it is not necessary that there should be a transfer of exclusive right in copyright. It is sufficient if consideration is paid for rights in respect of copyright and for user of confidential information embedded in software/computer programme, it would fall within mischief, of Explanation (2) of section 9(1)(vi) and there would be a liability to pay tax.

In the DTAA, the term "royalty" means payments of any kind received as a consideration for the use or the right to use any copyright of literary, artistic or scientific work. Therefore, under the DTAA it is sufficient if consideration is received for use of or the right to use any copyright. A mere right to use or the use of a copyright falls within the mischief of royalty.

- b. Samsung Electronics Co. Ltd. [2011] (345 ITR 494)(Karnataka High Court) When license is granted to make use of software by making a copy of same, store it in hard disk of designated computer, and to take back-up copy of software, what is transferred is only right to use copy of software for internal business as per terms and conditions of agreement and payment made in that regard would constitute royalty as per section 9(1) (vi), read with article 12 of DTAA between India and USA.
- c. Wipro Ltd. [2013] 355 ITR 284 (Karnataka)

The High Court held that payment made to a non-resident to obtain licence to use database maintained by it, is to be regarded as royalty both under the ITA and the relevant tax treaty.

The assessee made certain payments to a non-resident, on which no tax was deducted under section 195. The assessee submitted that the payment was akin to making a subscription for a journal or magazine of a foreign publisher and though the journal contained information concerning commercial, industrial or technical knowledge, the payee did not attempt to impart the same to the payer.

The High Court held that the access to database maintained by non-resident is granted online and such right to access would amount to transfer of right to use the copyright held by the non-resident and, thus, the payment made by the assessee to the non-resident is for the licence to use the said database maintained by the non-resident and is to be treated as "royalty".

d. CGI Information Systems & Management Consultants (P.) Ltd. [2014] 48 taxmann.com 264 (Karnataka)

The High Court held that the assessee engaged in rendering IT solutions to companies within CGI group and other global customers had entered into an agreement with CGI Inc., a Canada based company, in terms of which assessee acquired a licence to use intranet facilities provided by non-resident company. Thus, payment made for utilising said facilities amounted to "royalty" taxable in India.



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Bundled Software

Sophos Technologies (P.) Ltd [2018] 100 taxmann.com 374 (Ahmedabad Tribunal)

Under the facts of the case, the taxpayer had procured anti-virus and anti-spam software from AEs outside India and bundled those softwares with its own, which was ultimately sold to end customers as a bundled product. The revenue from the sale of software was recognised when the bundled product was sold to the customer. The royalty in respect of anti-virus and anti-spam software from AEs was paid only when the end customer i.e., ultimate user of bundled software activated license fee. The taxpayer created the provision for royalty to be paid and it was claimed as deduction. It was undisputed that WHT tax liability read with the tax treaty arose only at the point of time when the royalties were paid to the non-residents.

The TPO disallowed the entire provision for royalty as no tax was withheld at source. The ITAT held that the provision for royalty is deductible because the withholding tax liability had been discharged by the taxpayer as and when activation of key by the end consumer had taken place.

E-commerce

In case of sale of goods at a price less than the cost, AO cannot reject the real price and ascertain profit from transaction

O1. Flipkart India (P) Ltd [2018] [92 taxmann.com 387 (Bangalore ITAT)] In this case, assessee acquired goods from various persons and was immediately selling those goods to retail sellers and others, who subsequently would sell those goods as sellers on internet platform under the name "Flipkart.Com". It was selling goods to retailers at a price less than their cost price. The tax officer alleged that the loss incurred was for creating marketing intangible assets and thus, it is a capital expenditure.

The Tribunal held that where a trader transfers his goods to another trader at a price less than cost price and transaction is a bona fide one, taxing authority cannot take into account market price of those goods, ignoring real price fetched to ascertain profit from transaction.

Fees on successful completion of the transactions between the buyer and seller could not be described as FTS but business income

02. eBay International AG [2013] 40 taxmann.com 20 (Mumbai-Trib.)

The assessee, a Switzerland incorporated company, operated in India specific websites that provided an online platform for facilitating the purchase and sale of goods and services to users based in India. For the purpose, the assessee had entered into marketing support agreements with eBay India and eBay Motors, which were eBay group companies, to avail certain support services in connection with its websites. During the year, the assessee earned revenues from the operations of these websites which was claimed to be not taxable in India as the assessee had no PE in India.

The Assessing Officer concluded that the payments received by the assessee was fees for technical services (FTS) under section 9(1)(vii) and Article 12 and also had a permanent establishment in India in the form of its Indian entities.



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The Tribunal held that fees accruing to the assessee on successful completion of the transactions between the buyer and seller could not be described as FTS as the assessee had no role to play in effecting sales and that it was in nature of business profits. Further, it was observed that eBay India and eBay Motors were rendering marketing services to the assessee viz. creating awareness amongst the Indian sellers about the availability of the assessee's websites in India and certain support services. It was held that these concerns cannot be treated as the PEs of the assessee in terms of Article 5(2)(a) of the tax treaty.

Subscription fees for providing online social media monitoring services are taxable as royalty both under the ITA as well as the tax treaty

03. Thoughtbuzz P. Ltd (2012)(346 ITR 345)(AAR)

The applicant, a Singaporean company, is engaged to provide social media monitoring service for a company, brand or product. It is a platform for users to hear and engage with their customers, brand ambassadors, etc., across the internet. The applicant offers service by charging a subscription fee. The clients, who subscribes, can login to its website to do a search on what is being spoken about various brands and so on. The system operated by the applicant generates a report with analytics with an input provided by the clients. The information for generation of report is obtained from blogs and forum, social networking sites, review sites, question and answers sites, and twitter. The applicant does not depend on third party application programme interface feeds for data collection and has its own crawlers (computer programme that gathers and categorises information on the internet) for data extraction. The applicant argues that subscription fee received from the customers to provide social media monitoring services is not royalty within the meaning of section 9(1) (vi) and article 12 of the India-Singapore tax treaty, since no exclusive right or copyright is made over to the customer and what is passed on to the customer did not amount to information concerning the applicant's own knowledge, experience or skill in commercial and financial matters. The AAR observed that the applicant is in the business of gathering, collating, and making available or imparting information concerning industrial and commercial knowledge, experience and skill and, consequently, the payment received from the subscriber would be royalty in terms of section 9(1)(vi). Further, going by the India-Singapore tax treaty, it will qualify as royalty since it is the grant of the use for consideration or right to use for consideration, the process or information concerning industrial, commercial or scientific experience.

Therefore, subscription fees for providing online social media monitoring services are in the nature for use or right to use process or information concerning industrial, commercial or scientific experience and thereby taxable as royalty both under the ITA and the tax treaty.



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Payments under reseller agreement are not towards use of any IPR/ trademarks and cannot be taxed as royalty

04. Akamai Technologies Inc., In Re [2018] 93 taxmann.com 471 (AAR-New Delhi) The applicant, a US based technology company, received payment from its India group company under non-exclusive Reseller Agreement for sale of applicant's content delivery solutions directly to customers in India. The AAR held that such payments were neither taxable as FTS nor as royalty under the ITA or India-US DTAA. Solutions provided by applicant are in nature of a "standard facility" and do not cater to individual requirements of customer and is provided without human intervention. Therefore, the same cannot be termed as FTS under Explanation 2 to section 9(1) (vii). Further, solutions do not "make available" knowledge to end user so as to fall under definition of FIS under article 12 of the tax treaty. The essence of reseller agreement entered between applicant and reseller in India is not for a computer programme, rather it is for a facility that is provided by applicant to customers using applicants' own private network. Payments under reseller agreement are not towards use of any IPR/trademarks and thus, it cannot be royalty.

Fees for advertisement on website

Online advertisement hosting services are not in the nature of royalty but business profits

01. Yahoo India (P.) Ltd [2011] 11 taxmann.com 431 (Mumbai ITAT)
Assessee remitted payments to Yahoo HongKong (Yahoo HK) for services rendered for uploading and displaying the banner advertisement of the Department of Tourism of India on its portal.

It was observed by the ITAT that the banner advertisement hosting services did not involve use or right to use by the assessee any industrial, commercial or scientific equipment and no such use was actually granted by Yahoo HK to the assessee. The assessee had no right to access the portal of Yahoo HK and also, uploading and display of banner advertisement on its portal was entirely the responsibility of Yahoo HK. Thus, it was held that the payment made was not in the nature of royalty but was business profit and in the absence of any PE of Yahoo HK in India, it was not chargeable to tax in India.

02. Right Florists (P.) Ltd [2013] 32 taxmann.com 99 (Kolkata-Trib.)

Online advertising fees paid to foreign search engine company is not fees for technical services and is not taxable in India due to absence of PE of such foreign company in India.

The assessee used online advertising on search engines, i.e., Google and Yahoo, but did not deduct tax at source on payments made for same.



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The service which is rendered by Google to the assessee is generation of certain text on the search engine result page. This is a wholly automated process. There is no dispute that in the services rendered by the search engines, which provide these advertising opportunities, there is no human touch at all. The Tribunal held that for the reason that there is no human touch involved in the whole process of actual advertising service in the light of the legal position that any services rendered without human touch, even if it be a technical service, it cannot be covered by the limited scope of section 9(1)(vii). Thus, the receipts for online advertisement by the search engines cannot be treated as fees for technical services taxable as income, under the provisions of the ITA.

Contrary view:

01. Google India (P.) Ltd. [2018] 93 taxmann.com 183 (Bangalore-Trib.) & [2017] 86 taxmann.com 237 (Bengaluru – Trib.)

Where assessee made payment to Irish company (GIL) for purchasing of advertisement space under Google-USA's Adwords programme for resale to advertisers in India as also for post-sales services that included usage of trademarks, IPRs, brand features, derivative works and other intangibles owned by Irish company GIL, consideration so paid would be royalty liable to tax under section 9(1)(vi).

Further w.r.t Equalisation Levy, it was pointed out that equalisation levy is only charged on consideration for specified services and not for the services provided in the present case (i.e., use of IPR, copyright, etc.). The ITAT has clarified that since assessee had acquired license to use IPRs, copyright and other intangibles to provide better services, either to GIL or to the advertisers, the introduction of equalisation levy would not convert the nature of payment made by assessee to GIL.

Web Hosting services/website user fees for registration

Web hosting services not taxable as royalty

01. ERPSS Prepaid Recharge Services India P. Ltd v The Income tax Officer -1(4) [2018] 100 taxmann.com 52 (Pune Tribunal)

The assessee (engaged in the distribution of recharge pens of various DTH providers to its distributors via online network) had paid web hosting charges to Amazon Web Services LLC for hiring servers from Amazon. The Hon'ble ITAT held that the payment made by the assessee company is not "Royalty" as per India USA DTAA since,

- the assessee did not possess or have any control over the server deployed by Amazon while providing e-services,
- no rights in technology/IPRs are obtained by the assessee under the agreement,
- retrospective amendment to "royalty" read with Explanation 2 and 5 to section 9(1)(vi) definition under the act will not override treaty provisions.



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02. Savvis Communication Corporation [2016] 69 taxmann.com 106 (Mumbai-Trib.)

Payment received for providing web hosting services though involving use of certain scientific equipment cannot be treated as "consideration for use of, or right to use of, scientific equipment" which is a sine qua non for taxability under section 9(1)(vi), read with Explanation 2 (iva) thereto as also Article 12 of Indo-US DTAA.

03. People Interactive (I) P Ltd. [ITA No. 2180/Mum/2009]

Payments were made by the assessee to Rackspace for hosting charges. Here, it was observed that the assessee could not operate or have no physical access to the equipment system providing service and that the assessee would not be using the equipment but only availing the services provided by Rackspace. It was held that such payment will not be termed as royalty under the Act or under the India-US Treaty.

Services for domain registration is taxable as royalty since it involves use of intangible such as trademark

04. Godaddy.com LLC [2018] 170 ITD 217 (Delhi-Trib.)

The assessee was engaged as accredited domain name registrar authorised by Internet Corporation for Assigned Names and Numbers ('ICANN'). The assessee had income from domain registration fees, which was claimed to be not taxable in India. The Assessing Officer taxed the same as royalty. The assessee submitted that it merely facilitated in getting domain registered in the name of the customer who would pay a price for availing such services. Hence, the receipt in respect of domain name registration was not in the nature of royalty under Explanation 2 of section 9. Tribunal referred to the decision of Satyam Infoway Ltd. v. Siffynet Solutions (P.) Ltd. AIR 2004 SC 3540, wherein it was held that the domain name is a valuable commercial right and it has all the characteristics of a trademark and, accordingly, it was held that the domain names are subject to legal norms applicable to trademark. The rendering of services for domain registration is rendering of services in connection with the use of an intangible property, which is similar to trademark and, therefore, the Tribunal held that the charges received by the assessee for said services rendered in respect of domain name is royalty within the meaning of clause (iii) of Explanation 2 to section 9(1) (vi).



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Virtual/digital PE

Service PE can be created even if services are provided for a limited period by presence in India and thereafter the services are provided through virtual modes such as email, internet, etc.

01. ABB FZ-LLC [2017] 83 taxmann.com 86 (Bengaluru – Trib)

The assessee, a non-resident company, was engaged in the business of providing regional service activities for the benefit of ABB legal entities in India, Middle East, and Africa. It had entered into regional headquarter service agreement with its AE ABB Limited and rendered services to ABB Limited for which it received certain amounts as consideration.

The Tribunal observed that furnishing of services, including consultancy services, to ABB Ltd. for the project in India or with connected project was for a period of three months after commencing its activities in January 2010. Thus, it fulfils the prerequisite of service PE. In the present age of technology where the services, information, consultancy, management etc., can be provided with various virtual modes such as email, internet, video conference, remote monitoring, remote access to desk-top, etc., and through various softwares, the argument of fixed place of business raised by the assessee that three employees rendered services only for 25 days cannot be sustained, as the services can be rendered without the physical presence of employees of the assessee.

Interface processor owned by the subsidiary and used by the foreign entity can create a PE for the foreign entity in India

02. MasterCard Asia Pacific Pte. Ltd., In re. [2018] 94 taxmann.com 195 (AAR – New Delhi)

The Applicant, a Singapore based company, is engaged in processing of electronic payment transactions. It has an Indian subsidiary which owns and maintains MasterCard Interface Processor (MIP) placed at customers' locations in India that connects to MasterCard's Network and processing centres.

It was noted that the transaction processing activity carried out by the applicant consists of electronic processing of payments between banks of merchants and cardholders through the use of MasterCard Worldwide Network and the MIPs located at the customers' locations in India that connects to MasterCard's Network and processing centres.

Thus, the AAR held that the Applicant has a PE in India under provisions of Article 5 of India-Singapore DTAA as part of the activity is being carried out through the MIPs in India. Further, the AAR also alleged service PE and agency PE. Accordingly, a part of fees received/to be received by Applicant from Indian Customers was held to be classified as royalty. However, since the Applicant has a PE in India and it is effectively connected to PE, it would be taxed under Article 7 and not under Article 12.



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Issues w.r.t 10A/10AA deduction

Reduction of communication expenses from total turnover as well in case of deduction u/s 10A/10AA

01. HCL Technologies Ltd [2018] 93 taxmann.com 33 (SC)

The Supreme Court has pointed out that the rule of harmonious construction is the thumb rule to interpretation of any statue. It also observed that if the deductions on freight, telecommunication and insurance, attributable to the delivery of computer software under section 10A of the Act, are allowed only in export turnover but not from the total turnover then, it would give rise to inadvertent result, which would cause grave injustice to the taxpayer not being the intention of the legislature.

Thus, it was held that definition of "total turnover" for the purpose of section 10A would mean domestic turnover and export turnover and shall not exclude any expenses as per section 80HHC and 80HHE from total amount.

02. Amsoft Information Services (India) (P.) Ltd. [2014] 51 taxmann.com 115 (Karnataka)

Where communication expenses related to delivery of software was reduced from export turnover, same should also be excluded from total turnover while computing deduction under section 10A.

- 03. Similar views have been considered in the following judicial precedents:
 - Tata Elxsi Ltd [2012] 17 taxmann.com 100 (Kar.)
 - Larsen & Toubro Infotech Ltd [2014] 51 taxmann.com 49 (Bombay)
 - Genpact India [2011] 16 taxmann.com 234 (Delhi)
 - G.E. India Exports (P.) Ltd. [2017] 82 taxmann.com 464 (Bangalore-Trib.)
 - iNautix Technologies India (P.) Ltd [2016] 69 taxmann.com 53 (Chennai-Trib.)

Certain IT/ITES Tax issues

Indian company providing outsourcing work to foreign entity

01. E-Funds IT Solution Inc. [2017] 399 ITR 34 (SC)

Where Indian subsidiary company only rendered support services that enabled assessees (two American companies) in turn to render services to their clients abroad, this outsourcing work to India would not give rise to a fixed place PE. When the main business/ revenue generating activity of foreign enterprise is not carried on through a fixed place of business in India at the disposal of the foreign enterprise, it does not give rise to fixed place PE in India. Limited interaction of the India back office employees with the customers of the US entities viz. soft outbound calls for payment follow ups, responding to customer calls for certain operational aspects, handling simple queries may be treated as auxiliary services to main client service by the US entities.

02. Morgan Stanley & Co. [2007] 292 ITR 416 (SC)

The assessee, an investment bank engaged in the business of providing financial advisory services, corporate lending and securities underwriting services, outsourced activities such as equity and fixed income research, data processing, account reconciliations and IT enabled services to its Indian subsidiary. The assessee deputed employees to India for stewardship and management activities to ensure the quality of the outsourced services. It also deputed its employees who worked under the control and supervision of the Indian subsidiary. Under the service agreement, the Indian entity was remunerated on cost plus mark-up basis for providing back office services.



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The Court held that the Indian subsidiary could not be said to have a fixed place PE in India in terms of Article 5(1) of India-USA Tax Treaty in respect of the back office operations performed by it as the condition of carrying on of assessee's business through such fixed place was not satisfied. Further, the back office functions performed by the Indian subsidiary were in nature of preparatory or auxiliary in character and thereby get excluded from the fixed place characterisation of PE.

Secondment of expats to Indian entity

01. Morgan Stanley & Co. [2007] 292 ITR 416 (SC)

The assessee deputed employees to India for stewardship and management activities to ensure the quality of the outsourced services. It also deputed its employees who worked under the control and supervision of the Indian subsidiary.

The Supreme Court held that expats sent for stewardship activities are to monitor the outsourced operations to meet the output requirements of assessee, to protect interest of the assessee, and ensure quality control. Accordingly, such activities cannot be said to be services provided by the assessee to its Indian entity. It is a service to self and thus, there will be no service PE on account of stewardship and management activities.

As regards the deputation of expats to work under the control and supervision of Indian subsidiary, the Supreme Court observed that the said employees are having lien over their employment with the assessee and the assessee lends its experience to the Indian entity through these expats. Accordingly, such expats shall form a service PE of the assessee in India.

02. Centrica India Offshore (P.) Ltd. [2014] 364 ITR 336 (Delhi HC)

The High Court held that in terms of "secondment agreement" entered into by assessee with overseas companies, employees of those companies used their technical knowledge and skills while assisting assessee in conducting its business of quality control and management, amounts reimbursed by assessee to overseas companies towards salaries of seconded employees amounted to "fee for technical services" liable to tax in India. Special leave petition filed by the assessee was rejected by the Supreme Court [2014] 51 taxmann.com 386 (SC) and thus, indirectly affirming the aforesaid decision.

03. IBM India (P.) Ltd [2018] (100 taxmann.230)(Bangalore Tribunal)

The assessee company availed service of seconded employee of IBM group and reimbursed salary cost of expatriate employees to concerned IBM overseas entity. The assessee at the time of making payments did not deduct taxes at source since, the same was in the nature of reimbursement. The Hon'ble Tribunal held that in absence of a provision in India-Philipines DTAA the same would be taxed as per article 7 but since, the overseas entity did not have a PE in India, said income was not chargeable to tax in India.



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E-commerce

Identification of supplier in case of taxi aggregation service

01. Opta Cabs Private Limited [2018-VIL-26-AAAR]. It was observed that booking a taxi on the portal was crucial to the transportation services availed by persons, without which the taxi operators cannot provide services. The Appellate Authority for advance ruling, thus observed that the taxi aggregation service provider shall deem to be supplier and not merely a facilitator.

Identification of e-commerce operator as a dealer

02. Flipkart Internet (P) Limited vs. State of Kerala [2015 (11) TMI 159. The Kerala High Court observed that the sellers who were registered on the portal of the petitioner, effected sale of goods and not the petitioner himself.

Liability on the e-commerce operator to pay entry Tax

03. Flipkart Internet (P) Limited vs. State of Gujarat [2016 (12) TMI 1256. The Gujarat High Court held that levy of Entry tax on goods purchased by individual consumers through electronic commerce portal for their personal use and consumption is valid.

Contrary view:

a. Instakart Services Private Limited, WS Retail Services Private Limited vs. the State of Bihar, the Commissioner cum Principal Secretary, Commercial Taxes Department, The Deputy Commissioner of Commercial Taxes [2016 (10) TMI 84]. The Patna High Court ruled the matter in the favour of the sector.

With the entry tax being subsumed in GST, this is an opportunity for the operators to have better internal controls.

Online information and database access or retrieval services

Taxability on download of images from website

01. Photolibrary India Pvt. Ltd. (2017 (7) G.S.T.L. 386 (Bom.) Versus COMMR. of Service Tax, Mumbai-II).

The matter in question was on classification and taxability of transaction, wherein free access is allowed for purpose of viewing images and customer is charged for downloading images for commercial use. It was held by the Court that the services are provided in electronic form through computer network, and hence are considered as taxable services in the nature of Online Information and Database Access or Retrieval service ('OIDAR'). The matter pertains to period prior to negative list, and hence indicates a broader purview considered by Court for taxing services through internet under OIDAR services, the definition of which was later expanded in negative list based taxation regime of service tax. Over time, the definition of OIDAR has been evolved and the purview is expanded to include various e-services and online supplies of digital content. Now, the tax regime is converted into negative list based taxation, and hence the services automatically becomes taxable unless specifically excluded/exempted.



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Information technology software sServices

Service tax on cross charge for IT services from related parties outside India 01. Vishay Components India Pvt Ltd Vs Commissioner of Central Excise, Pune III [2017-VIL-1039-CESTAT-MUM-ST].

It has been observed that expenses related to various IT cost-on-cost sharing arrangement, paid to group company located outside India, shall be treated as import of services and recipient is liable to pay taxes under reverse charge mechanism. Whether the cost includes margin or contention that arrangement of cost sharing and does not take nature of consideration, it cannot be said that company has not received services from outside India. Hence, taxes are payable under reverse charge mechanism.

Information technology enabled services

01. Goods and Services Tax applicability on back-office support services as intermediary services

Vservglobal Private Limited (2018-VIL-270-AAR)

Applicant was engaged in providing back-office support services to overseas clients. The services included activities such as co-ordination with client's suppliers and customers for execution of purchase and sale contracts, creating and arranging documentation, liasoning on behalf of client, processing of payments, payroll processing, accounting of payments, etc.

Applicant contended that it is fulfilling all conditions required for the services to qualify as "export of services" and therefore covered under the definition of zero-rated supply. Applicant further contended that it is providing services to client on a principal-to-principal basis, and therefore is excluded from definition of intermediary services.

AAR observed that all activities performed by applicant for its client indicate that the applicant is engaged in "arranging/ facilitating" supply of goods or services between client and its customers. AAR also observed that the activities undertaken by the applicant in the instant case are for and on behalf of clients. Therefore, it was held that the applicant qualify as intermediary of services.

02. Goods and Services Tax applicability on support services for sale of software as intermediary services

M/s Sabre Travel Network India (2018-VIL-314-AAR)

AAR observed that applicant is covered by the definition of an intermediary because they are definitely acting as a broker/ agent and facilitating the process for sale of CRS Software that belonged to their foreign parent company, to the Indian subscribers because they identify such subscribers on their own in India.

Further, the applicant is not providing services on his own account and the sales and marketing support activities performed by the applicant will be considered as "Intermediary services" and IGST tax will be leviable.

AAR also stated the supply will be considered as inter-state supply as per Section 7 (5)(c) of the IGST Act 2017. Section 12 of the IGST Act will be applicable only when the location of the recipient and provider is in India and in the given case, recipient is located outside India. Hence, section 12 will not be applicable.



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Sale of digital products

Service tax on supply of digital camera as right to use

01. M/S. Qube Cinema Technologies Pvt. Ltd. Versus GST & CCE, Chennai North (2018 (5) TMI 887).

The Tribunal has observed that under the Service Tax regime, supply, installation, and operation of digital camera equipment to various theatre owners on right to use basis was considered as supply of goods, since the banner flex was a movable property, covered within the definition of goods and activity would not fall within the definition of services. This indicates ambiguity in the minds of the industry owing to the fact that Schedule II of CGST Act, 2017 provides for transfer of right to use any goods to be considered as supply of services.

Supply of information technology goods and services

Classification of supply under technology training agreement

IL&FS Education and Technology Services Ltd (2018-VIL-211-AAR)

Applicant is engaged to provide computer training services to Government aided schools across the state to implement Information and Computer Technology (ICT).

AAR held that the applicant is not just providing a supply of service, but is also providing a composite supply of goods i.e., hardware and network equipment, power equipment, etc. and services. Hence, it was held that the entire project cannot be termed as a training programme, which is entitled to exemption under specific entry of exemption notification no.12/2017 dated 28.06.2017.

Software operations (custom duty refund/ exemptions)

Refund of Special Additional Duty on import and sale of software.

As a measure of liberalisation, it is observed that time and again High Court have adopted a liberal view in refund case of Special Additional Duty on import and domestic sale of software holding that the refund cannot be denied in case of nonfulfilment of condition of documental declarations as long as the intention is made clear, even by the use of other words.

01. Schneider Electric IT Business V Commissioner of Customs and Service Tax, Bangalore [2018 (6) TMI 946]. The Karnataka High Court has held that the non-declaration in commercial invoice is an affirmation that no CENVAT credit thereof shall be available and the same satisfies the condition of the notification. Hence, claiming of refund cannot be rejected.



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Custom duty exemption on import of goods by Software Technology Park Unit 02. Customer Operational Services (Bangalore) Pvt Ltd Vs Commissioner of

Customs and Service Tax Bangalore [2018-VIL-38-CESTAT-BLR-CU]. In case of goods imported by Software Technology Park (STP) Unit on the in-principal approval from the STPI authorities, which were objected later by custom authorities. It was held that the customs authorities have to clear the goods duty free once STPI approval is received and goods are imported with valid certificate. Subsequently, if customs authorities are of the view that certain goods are not entitled for benefits, it is necessary for the Customs Department to take it up with the Commerce Ministry. Hence, it is clear from this judgement that once the STPI has received the approval for duty free imports, customs authority cannot object imposition of customs duty on such imports as content of not by authorised operations. Relevance can be drawn in the present context in case of SEZ units, wherein the supplies are prescribed to be zero rated provided they are used for authorised operations. However, it has been observed that assesses are facing challenges in refund claim of services being notified in approved list of services, wherein the supplies used for authorised operations is challenged by the hitherto ST authorities and refunds are denied. The methodology for endorsement of invoices by SEZ units in GST is yet to be standardised, while it has been prescribed as a mandatory requirement.

Export of software (fulfilment of conditions)

Eligibility of CENVAT credit refund claim by STP unit

01. Mobile Iron India Software Pvt. Ltd. Vs C.C., C. Ex. & S.T., Hyderabad-iv) [2017 (3) G.S.T.L. 518 (Tri.-Hyd.].

The Tribunal has held that on rejection of refund application filed by assesse located in Software Technology Parks of India, it was held that refund cannot be rejected on non-furnishing of Bank Realisation Certificate (BRC) in terms of FTP's Handbook of Procedure and SOFTEX returns from STPI authorities as per Foreign Exchange Management Act, 1999. It was observed that BRC is required only in respect of exports by post and SOFTEX returns are related to export of goods. Since, assesse had export of services, said requirements are not as per law and hence refund was allowed. This indicates the liberal view adopted by the Tribunal in allowing exports for IT related service providers. This is significant considering that the receipt of foreign convertible exchange is still one of the pre-conditions for qualifying services for export benefits under GST regime.



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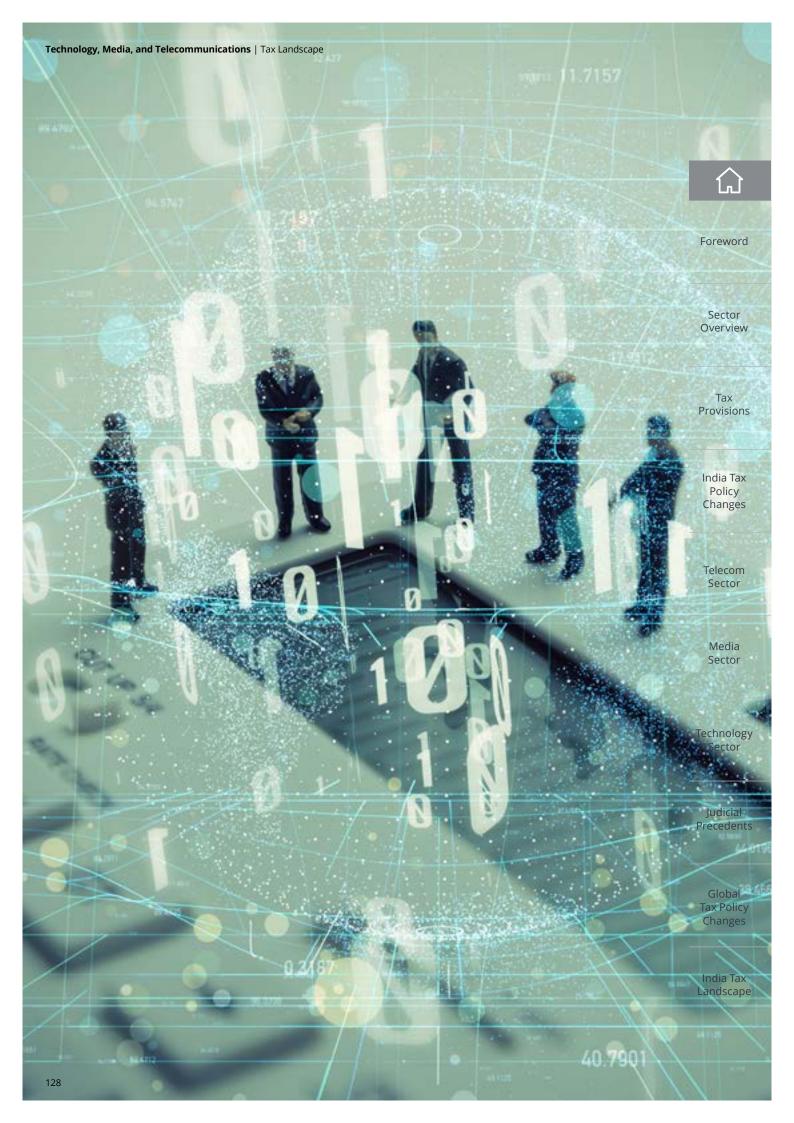
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Global tax policy changes: Impact on india

Base Erosion and Profit Shifting (BEPS)

The growth of international businesses has been historically accompanied by the development of strategies and structures designed to minimise taxes across the jurisdictions in which they operate. These actions have been countered by tax authorities' attempts to control what they consider to be abuses of the tax system through exploitation of the differences and asymmetries in the domestic and international tax rules. Multinational companies have been under attack for not paying their "fair share" of taxes, even as they emphasise that they have been following tax laws to the letter, and have been planning their affairs in a legally permissible manner. Incongruences in the current international tax rules can make profits "disappear" for tax purposes, or allow the shifting of profits to no or lowtax locations where the business has little or no economic activity. These activities are referred to as base erosion and profit shifting (BEPS).

The negative media coverage and widespread public ire towards these multinational companies have put political parties under pressure to seriously assess this matter. In September 2013, G20 leaders endorsed the ambitious and comprehensive Action Plan on BEPS. Typically, BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profit 'disappear' for tax purpose or to shift profits to locations where there is little or no real activity but taxes are low, resulting in little or no overall corporate tax being paid.

Apart from some cases of blatant abuses, the issues lie within the tax rules themselves. Instead of making investments for economic reasons, companies are often tempted to choose investments purely for tax reasons, leading to an inefficient allocation of resources. This also affects trust in the integrity of the tax system, an issue that is particularly important at a time of fiscal consolidation and social hardship in many countries. BEPS results in a loss of revenue for governments that could otherwise be invested to support resilient and balanced growth.

OECD's BEPS Project was launched after one of the most severe financial and economic crisis period during 2008, with an ambitious goal: to revise the rules to align them to developments in the world economy, and ensure that profits are taxed where economic activities are carried out and value is created. OECD identified 15 actions to combat economic under-funding, along three fundamental pillars: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards and improving transparency, as well as certainty for businesses that do not take aggressive positions.

The following key aspects of the BEPS initiatives are worth noting:

Digital economy taxation: Income Tax and Transfer Pricing perspective

Taxpayers in the e-space may no longer be able to effectively establish structures that separate the income from the



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value-added activities of their business, a phenomenon that was particularly intensified by the key features and business models of the digital economy. The BEPS measures, and in particular the ones on PE, transfer pricing and CFC rules, will also address BEPS issues intensified by the digital economy. Possible technical options have been proposed to deal with the broader challenges raised by the digital economy, i.e. those that go beyond BEPS. The country of taxation of business profits and the allocation factors in light of the economic reality is a subject matter of great debate in the context of digital economy and the BEPS Action Plan seeks to address these aspects. The options include alternatives to the existing threshold for taxing non-residents (a "significant economic presence" test); the imposition of a withholding tax on certain types of digital transactions; and the introduction of an "equalisation levy."

India being a part of the G20 and a key proponent of the BEPS project has been quick to incorporate provisions like equalisation levy and significant economic presence as part of its domestic tax law. India has drawn reference from not only BEPS Action Plan 1 but also closely inter-related BEPS Action Plans 6 and 7.

With the digital wave in India encompassing all spheres of the Indian TMT industry, it is of extreme importance to evaluate the implications of business models, in particular the emerging business models, in order to mitigate tax controversies under the new laws stemming from this global tax transformation.

OECD has also come-up with revised guidelines on application of Transactional Profit Split Method in June 2018 and will have direct bearing on the taxability of transactions involving IP in this space.

Digital economy taxation: Goods and Services Tax perspective

Cross-border trade creates challenges for VAT systems of countries owing to difference in taxing principles in each country jurisdiction. In this context OECD issued International VAT/ GST guidelines on place of taxation for B2B and B2C supplies and supplies of intangibles. India being one of participating nations has adopted guidelines for taxing cross-border transactions. This has put a tab on tax evasions and pointed towards potential yield of taxes in market jurisdictions to where the businesses belong.

Further, appreciating the complexities in business structures that are evolving in TMT space across the world, GST Law has prescribed specific provisions for taxing digital (electronic) supplies from OECD guidelines. As per GST Law, the Online Information Access and **Database Retrieval Services including** electronic supplies have been classified into B2B and B2C supplies wherein for cross-border supplies to end consumers, the supplier is required to obtain registration in India and undertake tax compliances. This results in alignment with overall global OECD principles of taxing supplies in jurisdiction of consumption.

In addition to the above, in October 2017, OECD released new implementation guidance to promote the effective collection of consumption taxes on crossborder sales. This guidance focuses on implementation of recommendations provided in 2015 for addressing tax challenges of digital economy. It broadly, covers designing VAT/ GST collection regimes that are based on requirement of foreign supplier to register and remit tax in jurisdiction of taxation through simplified registration and compliance regime. The effect of the same is already seen in Indian GST Laws wherein facilitation provisions are introduced to simplify the registration and taxation system for foreign suppliers in India to ensure effective tax collection mechanism.



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Modifications to tax treaties

Modifications to the Model Tax Conventions have been suggested to ensure that treaties solely aim at elimination of double taxation, rather than being medium of structuring transactions leading to erosion of country's tax bases viz. through dual residency, splitting up contracts, artificial avoidance of PE status etc. As per BEPS Action Plan 6, the minimum standard in the area of treaty shopping will ensure that treaty benefits are only granted to those entities that are entitled to them. The definition of Permanent Establishment has been modified to better reflect today's business reality and avoid widespread circumvention of the principle that underlines it. The amended provision will ensure that a business' core activities cannot inappropriately benefit from the exception for preparatory and auxiliary activities, and that the PE status will no longer be circumvented via the use of commissionaires or similar structures, or via the fragmentation of activities among different group entities. Other aspects of modification to tax treaties include adoption of revamped MAP norms by countries and inclusion of an arbitration window. OECD and UN have been prompt in embracing BEPS recommendations through their revamped articles and commentaries in relation thereto. The Multi-Lateral Instrument (MLI) is a medium to effect simultaneous modification of tax treaties on the suggested lines. In this context, in November 2016, over 100 jurisdictions concluded negotiations on the MLI. India signed the MLI along with 77 other jurisdictions on 7 June 2017.

other jurisdictions on 7 June 2017.
The signatories include jurisdictions from all continents and at all levels of development. While the signatories to the MLI include some of India's strategically important trading partners such as the United Kingdom, Canada, Germany, Japan and France, some countries, like the United States and Brazil, have chosen to not sign the MLI. Other countries such as Mauritius and Germany, while signing the MLI, have not made it applicable to their tax treaty with India.

It may be fair expectation that MLIs may come into force during FY 2018-19 considering OECD's and member nations' emphasis on implementing the suggested tax treaty modifications to prevent BEPS Since the consensus and agreement between sovereign states being an exhaustive and elaborate process with every state vying for supremacy and protection of its rights, the days ahead promise to be quite eventful. It is worth noting that India as a highly active member of the inclusive framework of the OECD shall not only be heard as one of the prominent developing nations for its views, but is also likely to bring in prompt amendments to its domestic tax laws. In this regard, it is pertinent to take note of India's position on certain key positions on MLI, as follows:

Strengthened transfer pricing rules and compliances

From a transfer pricing perspective, (specifically BEPS Action Plans 8 to 10) the guidance on the arm's length principle has been strengthened to ensure that economic realities solely form the basis of the transfer price in transactions between MNE. The OECD Transfer Pricing Guidelines now contain a clear and distinct framework indicating that while contractual arrangements are important, and serve as the starting point of any transfer pricing analysis, the arm's length principle is not based on superficial and untrue conduct of the parties. To this end MNEs will be required to submit information regarding their global business operations and transfer pricing policies in a "Master File". More detailed information regarding relevant related party transactions and the amounts involved in such operations will be submitted in a "Local file". The Countryby-Country Reporting (CbCR) will provide a clear overview to revenue authorities worldwide about the situs of profits, sales, employees and assets and where taxes are paid and accrued. Guidance and tools to ensure a swift and consistent implementation of country-by-country reporting across countries have been developed, to ensure the widest possible



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dissemination of information among tax administrations, while respecting the agreed safeguards on confidentiality, appropriate use and consistency. CBDT has recently issued a notification as to who will have access to the CbCRs, appropriate use of CbCRs, confidentiality of CbCRs, and process for monitoring, control and review of CbCRs. India has witnessed the first year of CbCR and Master File compliances pursuant to BEPS induced amendments in its domestic tax law.

Minimum standards towards consistent implementation

Minimum standards were agreed in particular to tackle issues in cases where no action by some countries would have resulted in adverse impacts of competitiveness on other countries. Recognising the need to level the playing field, all OECD and G20 countries have committed to consistent implementation in preventing treaty shopping, in Country-by-Country Reporting, in fighting harmful tax practices and improving dispute resolution.

BEPS Action Plan 5 is one of the four BEPS minimum standards in relation to countering harmful tax practices by sovereign states. The minimum standard of the Action Plan 5 consists of two parts-one part relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings, which, in the absence of such information exchange, could give rise to BEPS concerns.

BEPS Action Plan 6 is another minimum standard that deals with prevention of treaty abuse. This Action Plan basically includes changes to the OECD Model Tax Convention to prevent treaty abuse. It first addresses treaty shopping through alternative provisions that form part of

a minimum standard that all countries participating in the BEPS Project have agreed to implement. It also includes specific treaty rules to address other forms of treaty abuse and ensures that tax treaties do not inadvertently prevent the application of domestic anti-abuse rules. The report finally includes changes to the OECD Model Tax Convention that clarify that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping) and that countries should identify and consider tax policy considerations before deciding to enter into a tax treaty with another country.

The BEPS Action Plan 13 dealing with Transfer Pricing Documentation and Country-by-Country-Reporting provides a template for multinational enterprises (MNEs) to report annually, and for each tax jurisdiction in which they do business, the information set out therein. This report is called the Country-by-Country (CbC) Report. This is one of the four minimum standards to be adhered to by MNEs under the BEPS Action Plans. In order to facilitate the implementation of the CbC Reporting standard, the BEPS Action Plan 13 includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to ask the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports respectively, based on the model conventions.

BEPS Action Plan 14 on" Making Dispute Resolution more effective" is one of the minimum standards stipulated under the BEPS project. This Action Plan discusses the obstacles that prevent countries from resolving treaty-related disputes under the mutual agreement procedure (MAP) and recommended measures to overcome such obstacles, including a set of minimum standards ("the Action 14 minimum standard") to ensure that



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treaty-related disputes are resolved in a timely, effective and efficient manner.

From the perspective of the Indian TMT industry, evaluations of the nature of transactions embedded in various traditional and evolving business models of the sector are important to decipher the likely tax incidences on those transactions. Since there are multiple discussions and actions around Digital India, Artificial Intelligence (AI) and smart cities, besides similar others issues, it is important to track the recommendations under BEPS Action Plans and the manner in which these are being incorporated in Indian domestic tax laws. It is certainly expected that tax laws and practices shall certainly attempt to pace well with business evolutions. However, based on the extant and proposed law and practices adopted by other concerned nations, it is imperative to evaluate possible tax implications for emerging business models to some level of accuracy.

UN Model Tax Convention 2017 (UN MC 2017)

Unlike the OECD Model Tax Convention, which deals with needs of the developed countries, the UN Model Tax Convention has been specifically known to deal with the special needs of the 'developing countries'. At its inception, however, the dialogue in the UN Committee was dominated either by officials or scholars from the developed world. Although the UN Model gives more taxing power to the Source States, since its inception, there have been deliberate efforts to limit the differences between the OECD and the UN Model.

When the OECD embarked on the BEPS project upon strong insistence of the G-20 countries comprising of OECD and non-OECD nations in the backdrop of the global financial crises in 2008, in order to impart a layer of acceptability to developing countries, the OECD also formed what is known as the 'inclusive framework' where there is some

participation by the developing countries supposedly on an equal footing. India has been an active member of the inclusive framework and therefore had a major role in the drafting of the Multi-Lateral Instrument (MLI) as per BEPS Action Plan 15.

In the context of the OECD BEPS project, it may also be interesting to note that the UN had formed a subcommittee on BEPS and that subcommittee had prioritised some important issues and had sent a questionnaire that was also responded to by some of the developing countries. These responses indicated that transfer pricing, interest limitation, intangibles, treaty abuse, etc., as identified by the sub-committee were indeed of importance to these respondents from developing countries. That apart, Action Plan 7 relating to avoidance of PE status and Action Plan 1 relating to digital economy were also considered very important by the developing countries. Unfortunately, the OECD work in these two areas were least satisfactory.

At the outset, it may also be noted that source country tax base erosion may also arise because of the current distribution of taxing rights. The OECD, however, had made it clear that it was not going to address the issue at all even though this was of vital importance to many developing countries. The BEPS Action Plan explicitly stated that its actions "are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross border income". In this scenario, the 2017 update to the UN Model was finally been released on the 18 May 2018. A few aspects about the 2017 UN Model may help in appreciating the alignment of 2017 UN Model Tax convention with the BEPS recommendations.

 A modified title of the Convention and a new preamble of the Convention emphasising that treaties should not create opportunities for tax avoidance or evasion, including through treaty shopping.



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- A new version of Article 1 that includes a fiscally transparent entity clause, and a saving clause which clarifies that residence taxation is generally preserved under tax treaties; although this is an extremely welcome change, more clarity about specific types of fiscally transparent entities is essential.
- A modified version of Article 4 that includes a new "tie breaker" rule for determining the treaty residence of dual-resident persons other than individuals; this increases the onus on tax.
- A modified version of Article 5 to prevent the avoidance of permanent establishment status.
- Changes to Articles 23A and 23B to clarify that there is no obligation to provide relief for tax imposed on a solely residence basis.
- A new Article 29 that contains provisions relating to entitlement to treaty benefits. These include a limitation on benefits rule, a third state permanent establishment rule and a general anti-abuse rule.

The 2017 UN Model Convention suggests a new Article 12A to provide for source taxation of fees for technical services. This new article on FTS seems to accord additional taxing rights to developing nations on this important income source, specifically by doing away with conditions of "make available" as typically seen in certain tax treaties, viz. the India USA tax treaty.

From the perspective of the Indian TMT industry, it may be appreciated that due to the typical business models currently in vogue or expected to emerge from Indian direct tax perspective. Key evaluations happen around characterisation aspects of royalty, business income or fees for technical services. Transfer Pricing implications and withholding tax implications are allied implications in appropriate cases. Every business model involving intra-group and inter-group transactions have multiple

angles and thereby tax ramifications. Specifically, in light of the above referred new Article 12A, if India were to negotiate and amend its inforce tax treaties, a substantial revenue source through fees for technical services may benefit Indian exchequer. This being the case, an obvious futuristic question about the administration of the taxes and impliedly India's attractiveness on 'Ease of Doing Business' may come for consideration. Imperatively, the typical and emerging business models in the Indian TMT space may re-evaluate their tax positions in light of the evolving global tax policy changes having a bearing on India.

OECD Model Tax Convention 2017 (OECD MC 2017)

During the end of November 2017, the OECD approved the changes to the Model Convention, essentially incorporating amendments pursuant to the recommendations under the BEPS Action Plans. There were other amendments too as were released for public comments during July 2017. India has expressed its reservations on certain positions as per the 2017 Update to the OECD Model Convention. In light of the focus of this publication, it may be imperative to understand some of the relevant aspects and India's reservations thereon in brief.

01. Ambit of the phrase "Persons covered"

Article 1 of the OECD MC defines the persons covered for the purpose of tax treaties to include persons who are tax residents of one or both of the contracting states. In order to ensure that the tax treaty benefits are also available to fiscally transparent entities, a new paragraph (para 2) to Article 1 has been added to the OECD MC. The new paragraph provides that income derived by or through an entity or arrangement which is treated as wholly or partially fiscally transparent under the tax law of either state, shall be considered to be income of a resident of a contracting state, but only to the extent that, income is treated for the purpose of



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taxation by the state, to be income of a resident of that state. India has expressed reservation to include this paragraph in its tax treaties.

02. Tie-breaker rule in case of dual residency

The 2017 Update has amended the tie-breaker rule in case of dual resident entities to provide that treaty residence for dual resident entities shall be resolved only through Mutual Agreement Procedure (MAP) between the two involved countries, having regard to the place of effective management (POEM), the place of incorporation or any other relevant factors. It also provides that should an agreement not be reached through the MAP, such dual resident entities shall not be entitled to treaty benefits. Since India had advocated the above position during 2014 Update to the OECD MC, India withdrew its reservation on the point during the 2017 update.

03. Permanent Establishment

As per the 2014 OECD's Model Commentary, a website which is a combination of software and electronic data, does not create a PE since the enterprise does not have a physical presence at a location that can constitute a "place of business." On this, India reserved a position that a website can create a PE in certain circumstances or by virtue of hosting a website on a server at a particular location. India has indicated the following positions in the 2017 Update:

- The right to deem a PE if the foreign enterprise ('FE') has significant economic presence in India, as discussed in BEPS Action 1.
- ii. A website may constitute a PE where it leads to significant economic presence of the foreign enterprise in India. Depending on facts, a foreign enterprise can be considered to have acquired a place of business through a website on any equipment, if opening the website on that equipment includes downloading

of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with the enterprise.

The OECD 2017 Commentary in relation to Fixed Place PE stated that for the disposal test to be satisfied, the FE must have effective power to use the location as well as the extent of the presence of such FE at that location and the activities that such enterprise performs there.

If the foreign enterprise has an exclusive legal right to use a particular location, which is used only for carrying on such FE business activities, the foreign enterprise may be said to have met the disposal test. Any incidental or intermittent access to the space shall not make such space at the disposal of the foreign enterprise. India has expressed its reservations on this position stating that in certain circumstances, such location may be treated to be at the disposal of the foreign enterprise.

It has also been clarified by the above referred 2017 OECD Commentary, that while in general parlance, home office of employees will not be considered as a location at the disposal of FE only if it requires the individual to use his home office to carry on its business (by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of FE. India has expressed a reservation to the effect that home-office may constitute a PE where an office was made available to the employee but the employee performs the work out of his home office.

Since there has been debate about the PE exposures qua secondment of individuals who are formally employed by the FE and may be seconded to other enterprises, the captioned 2017 update clarifies that in such cases these seconded employees would actually be carrying on the



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business of the enterprise where they are seconded. Therefore, such foreign enterprise should not be considered to be carrying on its own business at the location where these seconded individuals perform work. India has not expressed any reservation on this position.

According to the OECD, there should be no impact on a foreign enterprise from a PE perspective merely because such foreign enterprise obtains VAT/ GST registration in the Source State. However, India considers that treatment under VAT/ GST can be a relevant factor from a PE perspective.

Pursuant to the recommendations under BEPS Action Plan 7, an additional clause is being proposed to be inserted in tax treaties for preventing an enterprise or a group of closely related enterprises from fragmenting a cohesive business operations into several small operations in order to argue that each is merely engaged in a "preparatory or auxiliary" activity. According to the OECD, unless the anti-fragmentation rule applies, each place of business should be looked at separately and in isolation to determine if a PE exists. India does not agree that unless the anti-fragmentation rule is applied, each place of business should be looked at separately and in isolation. There should be no dependent agent PE exposure, if the activities of the agent are preparatory or auxiliary in nature. The phrase "concludes contract" also includes contracts that are concluded by a customer accepting the offer made by a third party to enter into a standard contract with foreign enterprise (irrespective of the place from where the contract is signed). According to the OECD, a person who negotiates all elements and details of a contract in a way binding on foreign enterprise is said to have concluded the contract.

The phrase, "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification", is aimed at covering situations in which the

conclusion of contract directly results from the actions that a person exercises in a state and are intended to result in the regular conclusion of contracts to be performed by the foreign enterprise, i.e., where the person acts as the sales force of the foreign enterprise. However, where a person merely promotes and markets goods or services of the foreign enterprise in a way that does not directly result in the conclusion of contracts, a PE should not be constituted.

In respect of resellers/ distributors, the cases to which Article 5(5) applies must be distinguished from situations where a person concludes contracts on his own behalf.

India has reserved the right to exclude the word "routinely" in the newly-added provision. India disagrees with the interpretation dealing with distributors because it considers that the distribution of goods owned by a foreign enterprise through an associated enterprise or a closely connected enterprise, particularly in a case where the risks are not borne by such enterprise, such as the "low risk distributor," may give rise to a PE of the foreign enterprise (i.e. whose goods are being sold).

04. Mutual Agreement Procedure (MAP)

According to the 2017 OECD commentary, the competent authorities may enter into a Mutual Agreement Procedure (MAP) to define a term that is not defined under the tax treaty or to clarify the definition of a defined term, as may be necessary. Further, according to the commentary, the MAP can be set in motion if the taxpayer can establish that the "actions of one or both of the Contracting States" will result in such unwarranted taxation that is not merely possible, but probable. The tax treaty should provide for circumstances where access to MAP will be denied. India has expressed a view that the definition of an undefined term should be as per its domestic tax law and cannot be resolved by the MAP. India



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disagrees and is of the view that the MAP can be initiated only where taxation appears as a risk that is certain and not probable. Most changes in the 2017 update to the MC have also been included in the Multilateral Convention to implement Tax Treaty Related Measures (MLI). Since India is a signatory to the MLI, India may not sign any new tax treaty incorporating the changes and may choose the MLI route to include these changes. The tax authorities generally draw reference to India's reservations while interpreting the OECD Commentary in the context of tax treaties. However, it will be interesting to see how the appellate authorities treat these reservations in the context of pertinent disputes on the matter.

US Tax Reforms

The Tax Reforms enacted by US Congress, through the Tax and Jobs Cut Act (the HR1) significantly modifies key areas of US tax law, including many international tax provisions. These changes will have far-reaching implications, both domestically in the US, as well as in a cross-border context. It will affect both foreign investors in the US as well as overseas subsidiaries of US corporations. The Indian tax landscape also has seen radical changes over the last few years with the renegotiation of its tax treaties with Mauritius, Cyprus and Singapore, the introduction of the buyback tax and equalisation levy, and a phase-out of tax holidays.

Businesses with interests in India and the US must therefore look closely at the changes made to see how they affect their overall tax strategy in both countries. The broad categories of change relevant to India, which may also be relevant in the context of Indian TMT industry, are as follows:

A. Corporate tax rates and deductions-key elements:

- 01. Corporate tax rate cut to 21% and repeal of corporate AMT
- 02. Immediate write-off of new

- business investments in certain depreciable personal property over a period of 5 years
- 03. Subject to limitations around service-oriented businesses, a special deduction of 20% shall now be available to beneficiaries/owners of pass-through entities, which include partnerships, sole proprietorships and single member LLCs
- 04. NOLs for any year were allowed to be carried back by 2 years and carried forward for 20 years the HR 1 now caps post 2018 NOLs to 80% for set-off, no carry backs but indefinite carry forward.
- 05. Historically, to prevent double taxation of corporate earnings, corporations have been entitled to a dividends received deduction (DRD) of 80% for substantial investments of 20% or more and 70% for other non-controlling investments. The DRD for such investments would be reduced to 65% and 50% respectively.

Exemption from overseas dividends and deemed repatriation - key elements:

- 01. Shift to territorial taxation regime wherein, dividends received by a US corporation from a specified 10% owned foreign corporations shall be entitled to 100% deduction and as a corollary, the indirect foreign tax credits shall not be allowed. This will be applicable to distributions made after 2017.
- 02. The HR1 also includes "minimum tax" provisions of 10.5%- 13.13% to ensure that certain foreign earnings ("GILTI" or "global intangible low-taxed income") are not accumulated in tax havens or low or minimally taxed regimes.
- 03. Historical earnings (earnings and profits) however would be subject to a one-time transition tax of 8% or 15.5% on the "deemed repatriated" earnings amount, depending on whether the earnings are in the form of cash/liquid or non-cash/illiquid assets.



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Foreign tax credits triggered by such deemed repatriation would be made partially available, to offset the US tax. An option has also been given to the US shareholder to defer the payment of this tax liability over an 8-year period in instalments.

C. Interest expense limitations-key elements:

Prior to HR1 provision on interest deductibility limit, interest accrued or paid by a U.S. corporation is deductible in the computation of its taxable income. The proposals envisage putting in place additional limitations on the deductibility of interest by a US Corporation. Specifically, deductible interest expense of a US corporation will be limited to 30% of its "adjusted taxable income" for the relevant year, before taking into account depreciation (but only for taxable years through 2022). Disallowed interest may be carried forward to future years. And, special rules apply to the limitation in the case of partnership income.

D. Base Erosion and Anti Abuse Tax – key elements:

Currently, foreign corporations typically are not subject to taxation in the US unless their income is either effectively connected with a trade or business in the US or is US source fixed or determinable annual or periodical (FDAP) income. The HR 1 proposes 10% minimum tax (BEAT) on US persons making payments (including interest, but not cost of goods sold) to foreign related parties. For the year 2018 though, the applicable rate is 5%. From 2019 onwards, the 10% rate becomes applicable. This tax would not be a withholding tax limited by tax treaties, since it is a minimum tax on the US payer, and it is intended as a backstop to prevent further base erosion from the US, above certain limited thresholds. BEAT does not apply to LLPs. From India's perspective, the following aspects are worthy of consideration:

The first and most significant implication of the HR1 is that a corporate tax rate of 21% will make the US a far more attractive destination for foreign investment. The tax heavens would appear less preferable to the general investor communities. The India corporation tax rate of 25% for the INR 250 crores turnover companies would still indicate that for Indian entrepreneurs being US-outbound is a better proposition. The disadvantages for the Indian salaried class with Budget 2018 would also not go down well in the eyes of pro-employee US companies.

If one is considering US acquisitions subject to the views of M&A tax experts, it may be important to factor in the impact on NOLs, foreign tax credit allowability against the high US target valuations due to lower corporate tax rates, coupled with full expensing facility for asset or deemed asset purchases.

In India PoEM-induced tax residency norms pose challenges to overseas subsidiaries of India-headquartered business. India tax authorities may be less tempted to go after high tax paying subsidiaries on PoEM issues, since these subsidiaries post set-off of foreign tax credit, would effectively bring in nothing or less into the Indian kitty. With the lowering of US tax rates, this observation may not hold good for US subsidiaries of an Indian transnational. Hence PoEM reviews for those subsidiaries, should not be ignored.

Holding IP in the US would be better proposition than in India, especially for IP heavy sectors like Technology, Media, and Telecommunications sectors. Cash repatriations from India could be more expensive for US corporations, due to the closure of Mauritius treaty route and even buyback taxes. The HR1, while exempting foreign source dividends, have repealed the system of foreign



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tax credits. Hence, Indian corporate taxes plus DDT/ buyback taxes may not be creditable in the US anymore. Moreover, US corporations are required to pay deemed repatriation tax on their post 1986 earnings. In order to tide over cash flow issues, if such US corporations extract cash from India by paying India taxes, it has to be evaluated whether credit for Indian taxes can be availed of. Therefore, to this extent, the concerned US corporations may have a challenge.

Interest deductibility limitations in the US similar to India (section 94B) would necessitate review of US inbound debt structures.

The digital tax through business connection route may be another show stopper for a keen digital India, with US technology giants being skeptical about India nexus.

India outsourcing of work by US corporations would be a cost uncompetitive proposition due to the BEAT. Indeed the India outsourcing operations needs to be better planned for a willing US enterprise.

State Aid Norms Under the European Union (EU)

A significant development in global tax policies relates to the concept of "state aid" in the European Union. Under EU rules it is illegal for member states to give a selective economic advantage (including beneficial tax treatment through a tax ruling) to certain companies in a way that results in unfair competition and affects trade between member states. Therefore in the EU, corporate tax practices are being investigated for distorting competition and free market. This concept may impact, investments in EU by Indian conglomerates operating in the TMT space.

The European Commission State Aid investigations, which commenced way back in 2013, aimed to identify what they

consider to be unfair tax competition resulting from corporate tax practices in the EU.

For Multinational Enterprises (MNEs or multinationals), this means that they must now consider whether tax certainty can better be achieved with or without a ruling (given that rulings were precisely meant to provide such certainty); and whether or not a ruling is likely to increase the chance of subsequent litigation either (i) as part of an EC State Aid investigation, or (ii) with any other jurisdiction that will now have the benefit of knowing the existence and the details of such rulings.

In some situations it may be safer and better for multinationals to operate with a robust transfer pricing study or tax opinion, rather than request a ruling which could be subject to more intense scrutiny. Ultimately the EU's actions will certainly impact a jurisdiction's ability to offer, and consequently, a multinational's ability to benefit from tax competition. It may be noted that the challenges for multinationals are not limited to compliance and transparency issues

Staying up-to-date with global tax policy and controversy changes can be challenging for even the most dedicated tax departments. The global tax policy landscape has changed over the past several years and there are reasons to believe that it will continue to evolve for some time. Nowadays, international tax policies are being built, not only to raise revenue and redistribute wealth, but also to regulate corporate behaviour. Multinationals will need to be increasingly mindful of balancing business growth with potential financial and reputational risks. In view of the above, for business enterprises in the constantly evolving TMT space in India, it is of utmost importance to track the global tax policy changes vis-à-vis corresponding Indian tax policy changes.



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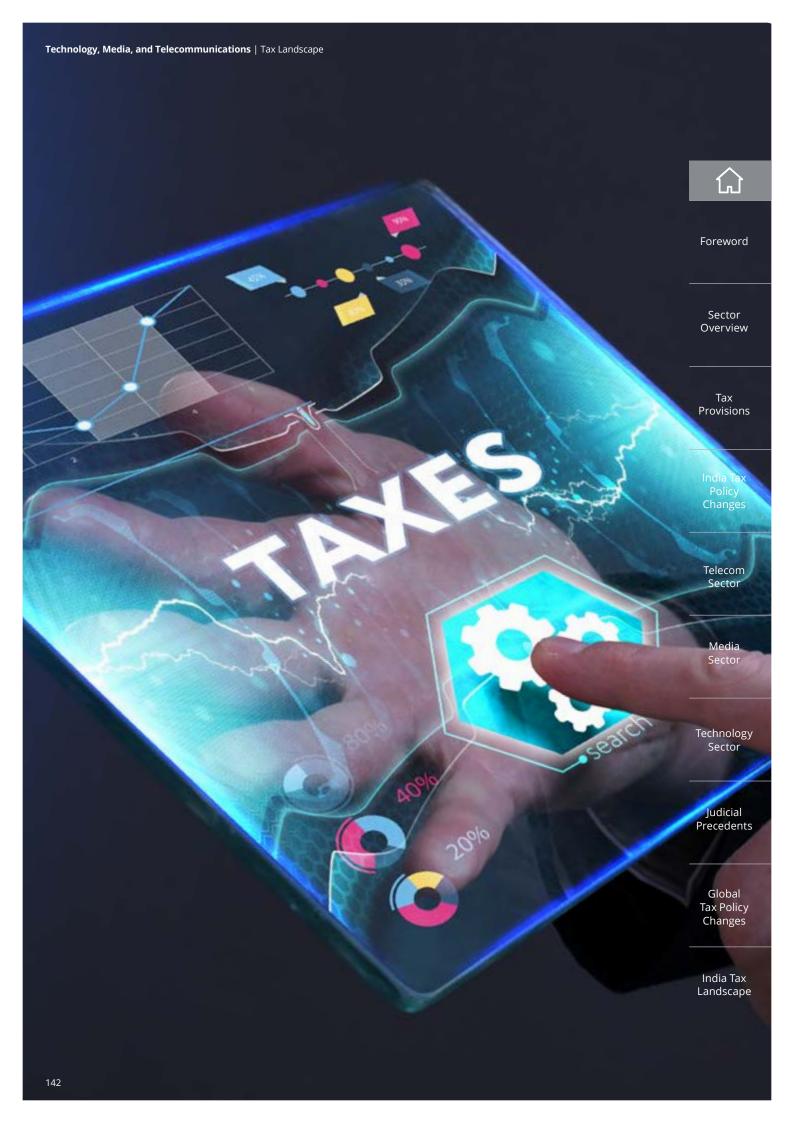
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India tax landscape: The road ahead

The telecommunications, media, and technology spaces remains buoyant as always with transformation spree undoubtedly the TMT industry continues to be one of the most fascinating and reckoning force of the Indian economy. Business models are changing to adapt to advancements in the digital economy. Accelerated by such advancements, 'digital' is a disruptive mega-trend that is enabling visibility into transactional data and unlocking value, helping to manage risk, improving real-time efficiency and providing critical business insights. Most successful technologies – from the radio to the eReader, from the steam engine to the fitness band undergo a period of rapid progression. In this era of relentless evolution, where technology is leaping forward and telecommunications and media is transforming for better customer experience, in an integrated and seamless manner, it is imperative to evaluate possible implications, under the evolving tax policies. Existing tax laws are based on legislations implemented in the 20th century; however, in light of the rapid developments in the TMT industry, these laws may require modifications to enable effective tax management. Therefore, it is necessary to remain abreast with these changes and understand the nuances of the evolving business models and related concepts. This knowhow would enable addressal of the probable tax issues, emanating from these under-transformation business trends.

The ensuing paragraphs reflect an attempt to touch upon possible tax considerations in relation to some of the evolving buzzwords in the space.

Artificial Intelligence and Robotics

Artificial Intelligence (AI) reflects the usage of cognitive functions by machines which imitate human minds in learning and problem solving, thus, almost mirroring the functions of a human being. Machine learning is a core element of Al. Machine learning represents a fundamentally different approach to creating software, where the machine learns from examples, rather than being explicitly programmed for a particular outcome. Al represents a new phase of technology that will pave way for the digital revolution and make future business more efficient. Al can broadly support three important business needs, i.e., automating business processes, gaining insight through data analysis, predictive and engaging with the customers and employees. Al uses many tools such as search and mathematical optimisation, neural networks, and methods based on subjects such as statistics, probability and economics. This evolving field also draws from computer science, mathematics, psychology, linguistics, philosophy, neuroscience and many others. For instance, in telecommunications sector, AI is supporting in predictive maintenance, self-optimisation of networks (SON System), optimal network quality, security attack prediction, improved customer experience. In a consumer goods Industry too, AI is being used for predicting grocery/shopping needs, and is predicting future purchase or delivering goods at the customer doorstep. Recently, Vistara Airlines has announced to station RADA, a robot at Indian airports to provide on ground service (such as scan boarding passes, information on departure gates,



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weather conditions, destination city and real time flight support, etc.) to its customers. Even in Indian cinema, Al does find application though not a common phenomenon yet. While there have been several English movies made around the AI concept, it is yet to see the light of the day in India. With all other sector seeing a surge in the usage of AI and ML, movies could not have been far behind for long. Before this, one Indian movie around the concept that garnered much attention was Rajnikanth's science fiction film Enthiran. The story revolves around the struggle of a scientist to control his creation, an android named Chitti, after its software is upgraded to give it the ability to comprehend and exhibit human emotions. Even Shahrukh Khan starrer RAONE demoed some facets of Al.

The use of AI transcends from the digital world to the physical world with robotics. Autonomous vehicles are already a reality. Sophia, a social humanoid robot has already been offered citizenship by Saudi Arabia and it will not be long before the use of AI based robots could act as a substitute for routine labour. This raises several questions whether the tax framework in place to deal with AI and robots is adequate. Taxation revolves around the determination of 'who' should be taxed and 'where' should that person be taxed in respect of a transaction. Such determination gets complicated with the evolution of technology and digitisation. Indian laws do not recognise AI entities to be 'person'. Income earned by Al/use of AI is realised by its programmer and is taxed in the hands of such person. Can AI, being actually autonomous, be accorded the status of a 'person'? In this scenario, questions about quantum of profit, Al's ability to taxes, and possibility of recovery taxes through proceedings may arise.

The idea of tax on robots was raised around May 2016 in a draft report to the European parliament prepared by MEP Mady Delvaux from the committee on legal affairs. The report emphasised on how robots could boost inequality in the aspect of taxation. Accordingly,

the report proposed that there might be a "need to introduce corporate reporting requirements on the extent and proportion of the contribution of robotics and AI to the economic results of a company for the purpose of taxation and social security contributions".

The public reaction to Delvaux's proposal has been overwhelmingly negative, with the notable exception of Bill Gates, who endorsed it. But with the proliferation of devices such as Google Home and Amazon Echo Dot (Alexa), which replace some aspects of household help, the Delphi and nuTonomy driverless taxi services in Singapore prompt for a deliberation on taxation of revenues arising out of these game changing innovations. If these and other labour-displacing innovations succeed, certainly there shall be need to consider alternative taxations around these technologies. There are instances where there have always been new jobs for people replaced by technology, but, as the robot revolution accelerates, one may not rule out robot taxes as part of a broader plan to manage the consequences of the robotics revolution.

All taxes have to be related to some activity indicative of ability to pay taxes and thus there is a potential inhibition to such activities. Taxes must be reframed to remedy income inequality induced by robotisation. It may be more politically acceptable, and thus sustainable, to tax the robots rather than just the high-income people. While this would not tax individual human success, it might in fact imply somewhat higher taxes on higher incomes, if high incomes are earned in activities that involve replacing humans with robots.

Until in a recent decision of the Authority for Advance Rulings (AAR) in case of Master Card Asia Pacific Pte Limited, wherein it was held that an automatic equipment can also constitute a PE, in the context of Fees for Technical services, courts have asserted time and again that 'fees for technical services', as defined under section 9(1) (vii) of the ITA, should involve a human element; in an activity.



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The landmark decision on this point being that of the Delhi High Court in the case of CIT v. Bharti Cellular Ltd. The principle of human involvement in this judgement was indirectly affirmed by the Supreme Court in CIT v. Bharti Cellular Ltd.

Under Indirect Tax Regime, there is always a dilemma regarding person who will be liable to taxes and the jurisdiction that will be benefitted out of a transaction. In Indian context, considering the stir Al continues to bring in the TMT space, it would be worthwhile to evaluate at some point in time whether a presence of Al in India manned by owner outside the country will also require provisions to tax the transaction in India.

It is observed that guided by various taxing provisions, the businesses in TMT space have started moulding their operations to a more suitable model such as local selling structures which are away from anomalies that are created in light of tax provisions. However, the eruptions from TMT inventions may not generate an ideal scenario at any point in time.

While Indian tax law is yet to place a grip on income generation attributable to Al applications and Robotics as new tax subjects, the debate around taxation of Robots and output from Al are far from over. There are more variables than one which require proper characterisation for tax purposes before stipulating the basis and quantum of taxation.

Blockchain and Cryptocurrency

In this digital era, there is a conscious effort on the part of finance service providers to offer customers the same or improvised services in a more efficient, secure, and cost effective way-Block chain technology was born. Block chain is, quite simply, a digital, decentralised ledger that maintains a log or record of all transactions that take place across a peer-to-peer network. Through the Block chain technology, transactions are embedded in digital code and stored in share databases i.e., public ledger. The public ledger maintains sequential record of all transactions and current

ownership. The transactions cannot be deleted or revised in the public ledger thereby keeping the trace of each and every transaction as an audit trail. The blockchain are databases that are not centralised but are collectively managed by a number of users.

The said technology is becoming increasingly famous on the digital platform with its unique feature which allows the distribution of digital information without permitting the same to be copied. The basic idea of using block chain technology is to remove the intervention of an intermediary party and thereby facilitate transactions of value between two parties directly thus, reducing the transaction charges. Further, block chain technology provides data on the distributed public ledger where transactions are recorded in a decentralised manner creating a trail of all the transactions thereby reducing illegal tampering of data.

Blockchain technology is being used by various banks and government agencies across the world because of the aforesaid advantages. Countries such as Honduras & Republic of Georgia are in the process of using block chain technology for maintaining all of its land records wherein the change in ownership shall be immediately recorded on the block chain network. The Estonian Government stores data of its residents on the block chain as a part of the e-Residency programme. From a business perspective, block chain technology could serve as a type of next-generation business process improvement tool that substantially reduces the cost of trust". Therefore this collaborative technology, may offer significantly higher returns for each investment dollar spent than most traditional internal investments. Understandably, financial institutions are exploring how blockchain technology may be used to facilitate everything from clearing and settlement to insurance. Block Chain was initially designed to facilitate, authorise, and log the transfer of cryptocurrencies.



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The currencies with which the world is largely familiar, are fiat currencies. The term fiat currencies denote legal tenders issued by Governments or central regulatory authority appointed by the Government in this regard. Cryptocurrencies or digital/virtual money are essentially digital tools of exchange that use cryptography and the aforementioned blockchain technology to facilitate secure and anonymous transactions. As evident from the above, while fiat currencies are centralised currencies, cryptocurrencies are decentralised. While there have been several iterations of cryptocurrency over the years, viz. Bitcoins, Ethereum, Litecoin, Dash, Monero, Ripple, etc., Bitcoins have so far been, the most popular amongst these currencies.

In the Indian context, the Ministry of Finance has clarified that it does not consider cryptocurrencies as legal tender or coin and it has taken measures to eliminate the use of these cryptocurrencies. Similarly, US IRS is of the view that virtual currency "does not have legal tender status in any jurisdiction. Moreover, virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as 'convertible' virtual currency. Instances of formal tax regulations and guidelines for cryptocurrency taxation are provided below:

Virtual currency as payment for goods or services

As per US IRS, Fair Market Value of the virtual currency in treated as the gross income as of the date of receipt of virtual currency. If FMV of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has a taxable gain. Sale or exchange of virtual currency

Sale or exchange of virtual currency
As per the US IRS and the National Tax
agency of Japan, if a person earns income
through the activity of buying and selling
Bitcoins, it needs to be seen whether
the person is trading in Bitcoins or is

he holding Bitcoins as an investment. Income from trading of Bitcoins should be business income; however, where trading is done without actual transfer of Bitcoins and the transaction is settled for value differential, then any income from such trading could be regarded as speculative in nature. In case Bitcoins are held as an investment, the income could be treated as Capital Gains. The Inland Revenue Authority of Singapore (IRAS) taxes profit derived from trading in token in the ordinary course of business but does not levy capital gain tax.

While we are aware that transaction in money is outside the purview of Indian GST provisions, the virtual currency presently does not find an exclusive mention on this list. Further, exchange or sale of such virtual currency could also be a subject matter involving GST implications.

Mining activity

Bitcoins are generated through mining operations. The US IRS taxes the fair market value of the virtual currency as of the date of receipt. However, the Australian Taxation office (ATO) taxes the revenue from Bitcoin mining operations only after considering deduction for allowable expenses. However, if the Bitcoin miner does not sell all his Bitcoins, then logically he should be taxed on the excess of the closing value recorded for Bitcoins over the expenditure incurred in generating the same.

Virtual currency as remuneration

As per the US IRS and ATO, the fair value of the virtual currency received in lieu of employment constitutes wages for employment tax purposes. Wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer, and are subject to federal income tax withholding and payroll taxes.

The challenges of the digitalisation of the economy were one of the main focuses of the BEPS Action 1. The G20 Finance



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Ministers mandated the OECD, through the Inclusive Framework on BEPS, to deliver an interim report [Tax Challenges Arising from Digitalisation – Interim Report 2018 (the Interim Report)] on the implications of digitalisation for taxation by April 2018.

G20 characterised cryptocurrencies as property, thereby adapting it as a new digital-asset-class. They committed to implementing Financial Action Task Force (FATF)'s anti-money laundering (AML) and terrorist financing standards as they apply to crypto-assets to mitigate concerns over security, consumer protection, and financial crime.

Members of OECD have agreed to undertake a coherent and concurrent review of the "nexus" and "profit allocation" rules, fundamental concepts relating to the allocation of taxing rights between jurisdictions and the determination of the relevant share of the multinational enterprise's profits that will be subject to taxation in a given jurisdiction.

From Indian income tax perspective, one has to analyse whether cryptocurrencies would fall under the definition of 'capital asset' or 'property', in order to be taxed under the head capital gains or income from other sources.

VoLTE and Lifi

Voice over Long-Term Evolution

(VolTE) is a standard for high-speed wireless communication for mobile phones and data terminals-including IoT devices. Voice over LTE (VoLTE) is a major advancement in long-term evolution (LTE) technology that brings both voice and data onto the same radio layer. VoLTE is a part of voice over mobile broadband (VoMBB). The VoMBB market is one of the most emerging markets globally. With the increased deployment of high speed package access (HSPA) and LTE networks, most telecommunications operators are entering into this exciting marketplace. VoMBB allows telecommunications service providers to manage the flow of mobile Voice over internet protocol

(VoIP) traffic generated by over-the-top (OTT) applications such as Skype and YouTube. This relationship between telecommunications carriers and OTT application service providers opens a new business model for telecommunications operators to generate revenues from VoMBB services. The integration between a mobile operator's cellular voice service and a Wi-Fi calling service is an emerging trend in the market. In the US, the popularity of VoWi-Fi is very high. Initially, consumers were dependent on over-thetop (OTT) applications such as Skype, WhatsApp, Google Voice, and Viber for video calling purposes. This requires users to download a separate application for its use. But, VoWi-Fi enables mobile phone users to use the same phone number as well as the same smartphone interface while making a call over any cellular network or Wi-Fi network, The big advantage of VoLTE is that call quality is superior to 3G or 2G connections as far more data can be transferred over 4G than 2G or 3G. Up to three times as much data as 3G and up to six times as much as 2G to be precise, making it easier to make out not only what the person on the other end of the line is saying, but also their tone of voice. Essentially it's an HD voice call and it's a much richer experience over all.

VoLTE can connect calls up to twice as fast as the current methods and as 2G and 3G connections will still be available when there's no 4G signal it simply means that there's greater mobile coverage overall, as currently places with a 4G signal but no 2G or 3G means that on you can't make or receive calls.

LiFi stands for Light Fidelity. It is a visible light communication system which runs wireless communications at very high speeds. In LiFi technology, light bulb acts as a router, it comprises multiple light bulbs (with signal processing technology) for high speed data communication. LiFi is aimed at being used in mobile devices for high-speed connectivity. Future home and building automation, building of smart cities, connectivity between hospitals, and communication between



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vehicles to increase road safety are some of the other proposed uses.

The Ministry of Electronics and IT of India has recently launched a pilot project to test the LiFi technology, which aims study LiFi as an alternate communication technology, and to explore LiFi opportunities in various deployment scenarios such as smart city, IoT, healthcare, education, transport, etc.

"Royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for the use of any patent, invention, model, design, secret formula or process or trade mark or similar property and rendering of any services in connection therewith. If one were to evaluate taxation of income from VoLTE and LiFi, one may get covered in the ambit of Explanation 6 to section 9(1)(vi) of the ITA as royalty. Explanation 6 to section 9(1)(vi) of the Act inserted by Finance Act, 2012 w.r.e.f. 1 June, 1976 provides that "process" includes and shall be deemed to have always included transmission by satellite (including uplinking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is a secret. However, it may be noted that payment to telecommunications operators towards connectivity charges without right to use 'equipment' or 'process' is not taxable as royalty; the retrospective amendment of 2012 under cannot fix liability to withhold tax on past payments. The tax aspects around the spectrum fees are important and would largely remain the same, even with these newer technologies.

Internet of Things (IoT) and Big Data

The Internet of Things (IoT) is a system of interrelated computing devices, mechanical and digital machines, objects which are provided with unique identifiers and the ability to transfer data over a network without requiring human-to-human or human-to-computer

interaction. In other words, anything that can be connected, will be connected. For example, alarm clock, besides waking up sends signals to coffee marker to start brewing a coffee, in traffic a car sending messages to the other party that meeting will be delayed.

The reality is that the IoT allows for virtually endless opportunities and connections to take place, many of which one cannot even think of or fully understand the impact of today IoT and its convergence with devices results in a lot of Big Data. Big Data typically involves voluminous and complex sets of data which are continuously collected due to the convergence of machines/devices on the internet. Big data enables the processed numbers/information to be systematised into predictive analytics and user behaviour analytics. The analysis is used to better understand customers and their behaviours and preferences. Companies are keen to expand their traditional data sets with social media data, browser logs as well as text analytics and sensor data to get a more complete picture of their customers.

With respect to tax implications surrounding the IoT environment, the key issue is on characterisation of income i.e., royalty, FTS or business income and secondly, risk of Permanent Establishment exposure on account of presence of any server/other electronic equipment and hosting of websites or other technical equipment, etc. Additionally, tax on account of use of rights, information and similar other intangibles being royalty have also gone paradigm shifts with multiple interpretations around the widened definition of royalty. Definition of Royalty under the ITA is wide enough to include consideration for license of computer software without any transfer of underlying IP. However, under the internationally accepted principles the definition is narrower.

Majority of IoT and e-commerce business models usually involve the use of or



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access to different kinds of scientific/industrial equipment without giving control/possession over such equipment. In such a case it may be treated as royalty under the ITA however, under the majority of tax treaties such payments are not construed as 'royalty' unless some element of control/possession is also granted over the equipment. Therefore, while interpreting tax treaties (which override domestic law), courts have held that such payments do not constitute "royalty".

Another argument from the revenue is access to or use of scientific/industrial equipment constitutes use of a secret formula or process, payment for which is also taxable as "royalty". Indian Tax authorities are contending that a website could constitute a PE in certain circumstances and have expressed reservations to the OECD commentary in this regard. Some other important reservations pertain to PE exposure from:

- a. Websites hosted on a third-party server which is not leased or otherwise available at an enterprise's disposal; and
- Leased automated equipment which is not operated and maintained by the lessor enterprise post set-up.

As referred to above, as in the context of Master Card Asia Pacific Pte. Limited, the conclusion of the AAR about how automated equipment in specific circumstances create a PE opens new vistas of interpretation in the technology tax space.

Taking a cue from the above, there is also a potential indirect tax trigger in case of remote technology set up in form of servers, etc. which control the IoT and Big Data which could be perceived as location of supplier of services. Such situations may warrant overseas service providers to obtain GST registration in India owing to principles of place of supply for electronic services. Such registration and compliances may be prescribed through placing intermediaries or obtaining registration by overseas service providers

themselves as casual dealers. The times are not far where these scenarios will have to be deliberated upon by the Governments to ensure tab on tax evasions and tax collections by relevant jurisdictions.

Further, the mechanism will require special focus on B2C supplies by overseas service providers which are more prone to tax leakages owing to volume and smaller quantum as per transaction. The GST requirements for registrations may indirectly impact Income Tax aspects around a set up and hence there will be a need for a holistic view on such business to ensure consistency in tax treatment.

Augmented Reality (AR) and Virtual Reality (VR)

Augmented Reality (AR) is an experience that combines the view of the real physical world with components of the digital world through multiple sensory modalities. The experience is augmented through computer-generated perceptual information such that it is perceived to be a part of the environment. With the help of AR technologies, the surrounding real world becomes interactive and digitally illusive. Augmentation techniques are typically performed in real time and in semantic context with environmental elements.

Any reference to AR is incomplete without mentioning the famous game "Pokémon Go" which brought AR to the masses. AR technology is on the rise and it is expected to be a 5.7 billion industry by 2021 impacting location based programmes, social networks and streamed media.

The Virtual Reality (VR) technology immerses users in a completely virtual environment that is generated by a computer. The most advanced VR experiences even provide freedom of movement – users can move in a digital environment and hear sounds. Moreover, special hand controllers can be used to enhance VR experiences.



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Tax aspects around AR/VR like any other emerging technologies remain varied and unanswered at this stage. Some of the aspects include:

- a. How should AR/VR content and transactions be characterised for the purpose of tax – as software, a digital product, a service or an intangible?
- b. What exactly is being purchased and how? Can it be categorised as a software, virtual currency or a digital assets?
- c. Where and when does the incidence of tax occur? – At the time when the identity or location of the user, owner of the intellectual property is not clear, or at the location where the user downloads in one jurisdiction but transact virtually in another.

There is an upsurge of digital activities. Additionally intellectual property owning entities in the AR space have structured and shifted revenues to low tax jurisdictions, thus requiring a reconsideration of the tax rules.

Content Streaming and Other Media Trends

The Video on demand, content streaming, hyper-targeted content and advertising, direct-to-consumer relationships, and mergers and acquisitions shall be the key themes of change and are likely to dominate the fast paced media sector. The growing adoption of streaming has helped spawn several other important developments viz, the emergence of vMVPDs— virtual multichannel video programming distributors. vMVPDs differ from traditional cable or satellite providers by delivering linear televission via ffan Internet connection rather than through a hard-wired set-top box. They offer less-costly subscriptions to a select group of channels.

- vMVPDs include DirecTV Now, Sling TV, and YouTube TV, among others, and they currently hold about 20% of the overall US subscriber market.
- Another rising trend is cord-shaving in the third quarter of 2017 alone, one million US viewers canceled their multichannel subscription television services,
- Opting instead for some combination of broadband Internet and IPTV, digital video recorders, digital terrestrial television broadcasts, or free-to-air satellite television.

These viewers clearly represent an enormous opportunity for media companies nimble enough to meet their needs. In response to these trends, media companies are increasingly going direct-to consumer with their own digital streaming services. For example, Disney recently acquired a tech firm that will help it launch its own streaming services, ending its distribution agreement with Netflix. Yet another area of opportunity for media firms is exclusive content for viewing in the home and on mobile devices. Consumers have an almost insatiable appetite for high-quality content, and a primary reason they subscribe to a platform is to access content they can't get anywhere else. eSports — multiplayer video-game competitions, sometimes involving professional players-is a US\$ 700 million industry that is expected to more than double by 2020.

Although the market is currently relatively small, eSports' players are often highly desirable from an advertising and marketing standpoint. One key question is whether the market will expand beyond its traditional male dominated demographic.



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These upcoming tech trends in the media sector shall lead to increased deliberations on characterisation of payments and portray the increasingly automated and easy to access mode of entertainment to man.

Advancement in technology has not only opened up doors for accelerated customer experience but also exposed concerned players to various tax issues, on which there is very limited guidance as of today. The national tax policy on digital transactions does not seem to be completely aligned in this regard and in some aspects, there is no international consensus on the taxation of the digital economy.

BEPS measures seeks to improve the coherence of international tax rules, reinforce their focus on economic substance and ensure a more transparent tax environment. As per the BEPS recommendations, business models are likely to be subjected to increased scrutiny with respect to assertion of permanent establishment, presence of marketing or sales personnel in India

or for presence of some equipment. There is also a likelihood of increased focus on withholding tax implications on digital products and services to non-residents. Although, through BEPS Action Plan and the Multilateral Instrument, the sovereign states have adopted an important step today towards resolving the tax challenges posed by the digital economy, however, with relentless evolution in the TMT space, it is imperative to align business models after careful evaluation of the recommendations under the BEPS action plans especially as regards anti abuse measures pertinent to digital economy, including evolving concepts of permanent establishments. The recent amendments under the Indian Income Tax Act towards connotation of the business connection qua significant economic presence, are worthy of consideration. To sum up, it is extremely important to remain abreast of the evolving law including pertinent jurisprudence both domestic and international, to evaluate the tax impact on the elements of an evolving TMT space.



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