APPENDIX 36 (TREATMENT IN INDIA – SOFTWARE TRANSACTIONS)

Material:

Shrikant S. Kamath, "Payment for Transfer of Software Is Not Royalty, Delhi Tax Tribunal Rules", *Tax Analysts*, January 13, 2009

Ruling of July 18, 2008 in Dell International Services India Pvt./Divyashree Greens Annexure (Applicant) and CIT (International Taxation) (Commissioner)

Payment for Transfer of Software Is Not Royalty, Delhi Tax Tribunal Rules

by Shrikant S. Kamath

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The Delhi Income Tax Appellate Tribunal on December 19 issued its ruling in *Infrasoft Ltd. v. ADIT*, holding that income derived from the transfer of licensed software is business profit and not a royalty.

The ruling specifically deals with the scope of the term "royalty" as it appears in section 9(1)(vi) of India's Income Tax Act, 1961 and the India-U.K. income tax treaty.

In the case at issue, Infrasoft Ltd., a company incorporated and resident in the United Kingdom, had a permanent establishment in the form of a branch office in India. The branch office was engaged in the marketing and supply of sophisticated civil engineering software developed by Infrasoft. The branch office licensed the software to various clients in India for use on a nonexclusive and nontransferable basis and provided support services, such as installing software, training on the use of the software, and so on.

For the 2003-2004 assessment year, Infrasoft filed an income tax return in India showing a net business loss. It showed the receipts for the branch office's activities as business profits and deducted the expenses incurred to earn that income.

During an audit of the tax return, the tax officer took the position that the income Infrasoft derived from the activities of its branch office in India was in the nature of a royalty under both ITA section 9(1)(vi)[1] and article 13 of the treaty. Because deductible expenses in the computation of business profits under article 7 of the treaty are subject to the limitations of the ITA, the tax officer noted, no expenses were deductible from

[1] Royalty has been defined to mean consideration (including any lump sum consideration but excluding taxable capital gains) for: the transfer of all or any rights (including the granting of a license) for a patent, invention, model, design, secret formula or process, or trademark or similar property; the imparting of any information concerning the working of, or use of, a patent, invention, model, design, secret formula or process, or trademark or similar property; the use of any patent, invention, model, design, secret formula or process, or trademark or similar property; 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 (with certain exceptions); the transfer of all or any rights (including the granting of a license) for any copyright, literary, artistic, or scientific work, including films or videotapes 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; and the rendering of any services in connection with the aforementioned activities.

Infrasoft's "royalty" income because of the prohibition contained in ITA section 44D;[2] therefore, the gross "royalty" income was subject to Indian income tax at a rate of 20 percent.

Infrasoft objected, reiterating its position that the receipts were in the nature of business profits. It also claimed that if the receipts are taxed as royalties, the expenses incurred to earn the income are fully deductible. Infrasoft relied on an amendment to the ITA (in the introduction of section 44D(A)) introduced in Finance Act, 2003 that allowed a deduction for expenses against royalty income earned by the PE of a foreign company. While that amendment was effective for the 2004-2005 assessment year, it highlighted the intention of the legislature to allow a deduction for such expenses while computing business profits, the assessee submitted.

The tax officer rejected Infrasoft's arguments. It assessed the receipts as royalties and taxed the income on a gross basis. Infrasoft appealed to the commissioner of income tax (appeals) and, after failing there, appealed to the tribunal.

Arguments

The Revenue Department made several arguments to support its view that the income Infrasoft received from the activities of its branch office in India constituted a royalty. In particular, it said the company's software is licensed and not sold outright. The copyright of the software therefore remains with Infrasoft, which has only authorized the client's use of the copyright in India. Any violation of that copyright would allow Infrasoft to take legal action as the owner of that copyright.

Further, the software can be considered a secret formula or process because when installed in a computer, it responds to every instruction in a specific way, the Revenue Department said. Had it not been secret programming, anybody could have written the same type of program and sold it at a much lower price, the Revenue Department said. Further, the cost of the medium on which the program is written is negligible as compared with the overall price of the software, it said.

Infrasoft countered that the receipts in question represented the transfer of a copyrighted article and not the transfer of a copyright per se. The right to use a copyright is distinct from the right to use a software program with an embedded copyright, as was the case here, it said. The company also argued that its clients had no right to exploit the copyright in the software (that is, they had no authority to duplicate the software or transfer or sublicense the software to another party).

In addition, the current practice adopted by the OECD and U.S. model income tax treaties is to characterize computer software payments as business profits rather than royalties, Infrasoft said, and it should be afforded the same treatment.

The Revenue Department, however, noted that the meaning and scope of the word "use" and the characterization of certain payments under article 13 of the OECD

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[2] Section 44D does not allow the deduction of any expenses in computing the business income of a foreign company in the form of a royalty.

model income tax treaty has not been accepted by many source jurisdictions, including Portugal and Spain. The inability to reach an international consensus on characterization issues signals a more fundamental concern of countries such as India, which may perceive that they may not be able to adequately share in the revenues generated by transactions such as the one in question, it said. Countries that perceive that they are unable to share in the revenues generated by electronic commerce may take unilateral measures to tax what they believe may be base-eroding payments, the Revenue Department argued. In any case, India is not a member of the OECD and there is no need to rely on the commentary supporting such payments as not being in the nature of a royalty, it said.

Infrasoft also referred to the Supreme Court decision in *Tata Consultancy Services v. State of Andhra Pradesh.* The Revenue Department said that the decision was taken out of context because it dealt with sales tax law and not income tax law. Infrasoft countered that the transfer of software programs was held to be a "sale of goods" by the Supreme Court, which relied on the extended definition given in the relevant sales tax law. At the same time, the Court held computer software to be goods within the meaning of article 366(12) of the Indian Constitution. Relying on the principle of that ruling, Infrasoft argued that the incorporeal right to the software is the copyright, which remained with the company, and that what is sold is a copy of the software, which is akin to buying a novel from a book store or a recorded song. As such, the income in question is business profit and not royalty, it said.

Tribunal's Ruling

The tribunal agreed with Infrasoft and held that the income in question was not a royalty but business profit, taxable as such on a net basis under article 7 of the India-U.K. income tax treaty.

The tribunal also referred to Indian copyright law, which defines copyright in the case of a computer program to mean the exclusive right to authorize or:

- reproduce the work in any material form, including storing it in any medium by electronic means;
- issue new copies of the work to the public;
- make any translation of the work;
- make any adaptation of the work; and
- commercially sell or rent any copy of the computer program.

Therefore, if the licensee does not have any of those rights, as was the case here, they do not have any right to the copyright, and the payment made cannot be characterized as a royalty either under the ITA or the India-U.K. treaty, the tribunal said.

The granting of a nonexclusive restricted license by Infrasoft to its clients to use the software meant that Infrasoft could supply similar software to any number of persons

to which the licensee could have no objection, the tribunal said, adding that this did not make the character of the consideration a royalty.

The tribunal also cited the Delhi Income Tax Appellate Tribunal's special bench ruling in *Motorola Inc. v. DCIT* (95 ITD 269), which established a similar principle. (For a related analysis of software taxation in India, see *Doc 2008-19650* or *2008 WTD 217-8*.)

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BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)
NEW DELHI

PRESENT

Hon'ble Mr. Justice P.V. Reddi (Chairman)

Mr. A.Sinha (Member)

Mr. Rao Ranvijay Singh (Member)

- (Member)

A.A.R. NO. 735 OF 2006

Name and Address of Applicant

Dell International Services India Pvt. Ltd., Bangalore
Divyashree Greens Annexure, Inner Ring Road, Domlur Post, Bangalore

Commissioner concerned

CIT (International Taxation),Bangalore

Present for the Department

Mr. S.D.Kapila, Adovate, Mr.Veshwant U.Chauvan,Addl.CIT, Mr.Prakash Chand Yadav, Advocate

Present for the Applicant

Mr. N. Venkataraman, Sr.Advocate, Ms. K.Indira, Advocate, Mr.Pramod Jain, Tax Director, DELL

RULING

(By Mr. Justice P.V. Reddi)

1. The applicant, Dell International Services (India) Pvt. Ltd., (hereinafter referred to as "Dell India") is a part of the Dell group of companies and it is a company

registered in India. The previous name of the applicant company (before 29-10-2005) was Dell Computer India (P) Ltd. It is mainly engaged in the business of providing call centre, data processing and Information technology support services to its group companies. The applicant submits that it has entered into an agreement with BT America (hereinafter referred to as 'BTA' or BT) - a non-resident company formed and registered in USA under which BTA provides the applicant with two-way transmission of voice and data through telecom bandwidth. While BTA would provide the international half-circuit from the US/Ireland, the Indian half circuit is provided by Indian telecom company, namely, VSNL with whom BTA has a tie-up. The bandwidth so provided by BTA would give full country coverage in both the countries of delivery, i.e. USA and India. The applicant states that under the Agreement, a fixed monthly recurring charge for the circuit between America and Ireland and for the circuit between Ireland and India is payable to BTA. Installation Charges as specified in the Order Form are also payable initially. The payment to BTA is net of any Indian taxes, including withholding taxes, as may be applicable. The applicant states that in consideration of the services rendered, BTA raises its invoices on Dell India (the applicant) and it is Dell India that directly makes payments to BTA and the amounts so paid are not being cross-charged to Dell U.S. The applicant states that it has been discharging the tax obligations arising out of payments made to BTA in accordance with sec. 195 of the Income-tax Act. The applicant avers that there is no equipment of BTA at the applicant's premises and the applicant has no rights over any equipment held by BTA for providing the bandwidth. The applicant submits that the payments made to BTA are not liable to be taxed in India either under the Treaty provisions or section 9(1) of the Income-tax Act, 1961. It is also the contention of the applicant that in the absence of Permanent Establishment of BTA in India, the consideration paid to BTA cannot be subjected to Indian income-tax and therefore, withholding of tax is not required by law.

2. About the agreement, a clarification is necessary. A perusal of the application would give an impression that the applicant entered into an agreement directly with BTA but it has been subsequently clarified by the applicant that there was no

such formal agreement between the applicant and the BTA. The applicant stated in its rejoinder dated 6.2.2007 that its parent company Dell-US entered into a Master Service Agreement (MSA) with BTA on 1.1.2003 with a view to obtain favourable prices for the Dell group as a whole and in pursuance thereof two other documents known as – (i) BT Pvt. Line International Service Schedule(for short 'ISS') and (ii) BT Pvt. Line Connect Service schedule (for short 'CSS') came to be executed by the same parties which are brought on record. According to the applicant, the two Service Schedules are in the nature of purchase orders to the MSA. For convenience, they are also referred to as 'Agreements' hereinafter. It is pointed out that the purpose of entering into such arrangement was to enable Dell entities in the respective countries to utilize the services of BTA. The applicant enclosed a letter dated 6.1.2006 addressed by the applicant to BTA confirming the terms of the agreement between Dell US and BTA. It is submitted that the applicant answers the description of 'customer' wherever it is used in the agreements and the order form annexed to the agreements. Moreover, the fact that the invoices are raised on the applicant which in turn makes payments to BTA also indicates that the privity of contract is established between the applicant and the BTA. The applicant is as much governed by the terms of the two agreements (Service Schedules) as its parent company – Dell US.

3. The facts stated in BTA's letter dated 18th May, 2007 addressed to the applicant (Dell-India) also deserve reference while narrating the facts. It is stated therein that BT and its affiliates jointly with VSNL provides telecom services to Dell India to carry voice and data traffic from US and Ireland to India and back through dedicated private telecom lines. BT or its affiliates which are licensed telecom operators in Ireland and USA provide the US and Irish element of the service while VSNL (a licensed operator in India) provides the telecommunication service in India. It is further stated that these services are provided through sub-sea cables and telecom network owned or leased by BTA or VSNL. BTA states that it "has neither installed any equipment at DIS facilities nor placed any of these items at DIS's disposal or use elsewhere." (DIS is applicant)

4. The applicant has stated at para 4.5 of Annexure IV that the same fiber link cables and other equipment are used for all customers including the applicant. In the applicant's letter dated 7th February, 2008 addressed to the ITO(International Taxation) Ward 1(1), Bangalore, the applicant further clarified that the telecom bandwidth is provided through a huge network of optical fiber cables laid under seas across several countries. These cables run into more than 20,000 kms. BTA is using the South East Asia-Middle East-West Europe cable network which is owned by a consortium of 16 international telecom companies including Bharti, Airtel and VSNL from India. This network, it is stated, links South East Asia to Europe via the Indian Sub-continent and Middle East with terminal stations in various countries. The applicant states that BTA uses only a small fraction of this network and reiterates that the space in the cable network is not dedicated to the applicant alone but is also used by hundreds of BT's customers in and outside India. The applicant submits that "there is no dedicated machinery or equipment identified and allowed to be used in the hands of the applicant. A common infrastructure is being utilised by various operators to provide service to various service recipients and the applicant is one amongst them receiving the service" and it neither uses nor has acquired a right to use any machinery, equipment or infrastructure. The applicant confirmed after contacting BTA that the landing site in India is at Mumbai (not Kochi as stated earlier). The applicant further states that BTA has confirmed that it does not have any machinery installed at the landing site in India.

5. On the basis of facts that came to light after the application was partly heard, it needs to be stated that the landing site of the Integrated Private Leased Circuit (IPLC) provided by BTA is at VSNL Premises at M.G. Road, Fort, Mumbai. The Indian leg of IPLC from Mumbai to Bangalore (where the applicant is stationed) is catered to by Bharti Telecom. The last mile connectivity within Bangalore and upto the premises of the applicant is also provided by Bharti Telecom. It appears that the contract was directly entered into by BTA with VSNL and Bharti Telecom. It seems that VSNL is only involved to the extent of having custody of the landing site and is not concerned with further transmission of the signals

within India. These facts were reported by the Director of Income-tax,International Taxation, Bangalore, after inquiry and the applicant was put on notice thereof. The applicant's version that VSNL provides and manages the Indian half circuit is, therefore, not fully correct. We may also mention that the applicant did not file any documentary evidencing the inter-se arrangement between BTA and VSNL / Bharti Telecom. The applicant has also not furnished any details regarding the domestic access line provided by the Indian telecom service

Provider or the equipment placed at its site in Bangalore by the Indian service provider or the equipment deployed by the applicant at its site to establish connectivity etc.

6. The applicant sought advance ruling on six questions framed by it. At the time of admission of application, after hearing the arguments of both the counsel, Question no. 1 was recast and question no. 6 was substituted by question nos. 6 to 8. Thus, the following questions were formulated for consideration:-

1. Whether or not the amount payable by the applicant under the terms of "BT Private Line Connect Service Schedule" – the agreement between the Dell US and BT America (which has been confirmed by the applicant) read with the Master Service Agreement would be in the nature of "fees for included services" within the meaning of the term in Article 12 of the Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income and Capital gains entered into between the Government of Republic of India and the Government of US (for short the "Treaty").

2. Whether the amounts payable by the applicant under the terms of the Agreement would be in the nature of "royalty" within the meaning of the term in Article 12 of the Treaty, or not?

3. Whether the amounts payable by the applicant under the terms of the agreement would be in the nature of "Fees for technical services" within the meaning of the term in Explanation 2 to clause (vii) of section 9(1) of the Act, or not?

4. Whether the amounts payable by the applicant under the terms of the Agreement would be in the nature of "royalty" within the meaning of the term in Explanation to clause (vi) of section 9(1) of the Act, or not?
5. If the answer to question ((3) and/or (4) above is in affirmative, whether the amounts paid by the applicant are for the purposes of making or earning any income from any source outside India and hence covered within the exception carved out in section 9(1)(vii)(b) or 9(i)(vi)(b) of the Act, as applicable or not?

6. Based on the questions 1 to 5 above and in view of the facts stated in Annexure-III, whether the applicant is required to withhold taxes under sec. 195 of the Income-tax Act on payments made to BT Americas as per the Agreement or not?

7. Whether the declaration of B.T. America that it does not have a 'permanent establishment' in India as defined in Article 5 of the Indo-US Treaty is correct, and if so, whether and to what extent it has bearing on the applicant's obligation to withhold tax on payments made to B.T. America ?

8. To what relief, if any, the applicant is entitled?

Royalty

7. Question nos 2 and 4 go together and they are core questions addressed before us. As we have to primarily deal with those questions, we would like to consider them in the first instance. Whether the amounts (recurring charges) payable under the Agreement would be in the nature of 'royalty' (a) within the meaning of the said expression in Article 12(3) of the Treaty, and (b) within the meaning of that term in Explanation 2 to clause (vi) of section 9(1) of the Income-tax Act, more especially (iv)(a) of the said Explanation? In short, these are the questions. Section 9 in so far as it is relevant for our purposes enjoins that income by way of 'royalty' payable by a person who is a resident shall be deemed to be the income accruing or arising in India [vide sub-clause (b) of Sec. 9(1)(vi)]. There is an exception provided in sub-clause (b), which is relevant, to question no. 5 and it will be dealt with later.

7.1. The definition of 'royalty' as contained in Explanation 2 has six limbs. We are most concerned with clause (iv.a). Clause (iii) has also been referred to by DIT in his comments. Clause (iv.a) was inserted into the Explanation 2 to Sec. 9(1) by the Finance Act, 2001. According to the said clause, the consideration for the 'use' or 'right to use' any industrial, commercial or scientific equipment other than the amounts referred to section 44BB comes under 'royalty. Whether any consideration is payable for the use or right to use the scientific/commercial equipment is the question that looms large in the instant case. Whether the payments made by the applicant are in the nature of consideration for "the use of any patent, model, design, secret formula or process* within the meaning of clause (iii) to Explanation 2 is another question that arises.

7.2. The definition of 'royalty' in Sec. 9(1) of the Act, it may be noted, is not materially different from that in the Treaty. Article 12(3) of the Treaty defines "royalties" to mean:

(a) payments of any kind received as a consideration for the use of or the right to use, any copy right of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8. (emphasis supplied)

7.3. It is well settled that if the Treaty is more beneficial than the domestic law provisions, the advantage should go to the tax-payer. In the event of conflict, the Treaty provision will prevail. However, if the domestic law provisions are more

beneficial to the assessee, they have to be given effect to [vide section 90(2) of the I.T Act]. Such situation does not really arise in the present case because of the substantial similarity in the definition of the term 'royalty'.

Applicant's contentions:

7.4. The sum and substance of the arguments advanced by the learned sr. counsel appearing for the applicant and those reiterated in the written submissions filed on 1st October, 2007 are these:

The agreement and arrangement entered into with BTA does not involve the use or right to use any equipment within the meaning of clause (iv.a) of Explanation 2 to section 9(1)(vi) of the Income-tax Act, 1961 or Article 12(3) of the Treaty1 and therefore, the consideration paid to BTA by the applicant is not in the nature of royalty, as contended by the Revenue. The transaction is essentially one of providing bandwidth service for the two-way transmission of voice and data. The consideration is paid for rendition of such service by BTA by means of a point-to-point dedicated circuit owned by the service provider, namely, BTA. Rendition of service by service provider using its own equipment does not attract the definition of royalty. The consideration stipulated is only for delivery of package of services, the applicant being recipient of service. The Agreement obligates BTA to utilize its 'leased circuit' for rendition of service to the applicant so as to give full country coverage in both countries of delivery i.e. Ireland and India. Leased circuit means a dedicated link provided between two-fixed locations for exclusive use of the subscriber. Both possession and control of the leased circuit and related equipment is only in the hands of BTA and not with the applicant. BTA has to maintain and monitor the network and infrastructure for the purpose of rendering service to the applicant. No equipment or machinery has been installed at the applicant's premises much less they were kept at the disposal of the applicant. The equipment if any placed at Dell's Premises cannot be changed or tampered with by the applicant. Such placement is only for rendering of service by BTA, but not to facilitate its use by the applicant. Transactions involving leasing or hiring of equipment cannot be compared to the present transaction which involves the receipt and consumption of service and payment of charges towards the services

made available. The use of the expression 'rental charges' in Section2.1 of the Agreement is not apt but it has borrowed the usage in vogue in telecom industry. The real nature of the amount has been correctly described as 'recurring charges' in section 6.4 of the Agreement. There is nothing to suggest that any payment is made towards usage of equipment. Explanation 2(iv-a) is invokable only when the consideration is paid for using the rights over intangible properties or tangible equipments/goods.

Contentions of Revenue

7.5. The contentions of Revenue may be summarized thus: Use of equipment clause common to both Treaty and Section 9(i)(vi) of the Act, is squarely attracted to the present case. The applicant is clearly in physical possession of the equipment since it is installed in its premises, even though the ownership thereof rests with BT. The access line consisting of circuits is within the reach of the customer and it is through that private line/ access line and related equipment placed at Dell's premises in Bangalore that the required bandwidth is provided. Circuit, it is pointed out, is a system of electrical conductors and components forming a complete path through which current flows and it is undoubtedly "equipment". So also, the bandwidth produced by the circuit is also equipment over which the applicant has control. The circuit is available for all 24 hours on a fixed rental, as mentioned in section 2.1. The fixed rental or charge is relatable to the equipment which comes into the custody and control of applicant under the terms of the Agreement. The charges have no nexus with the volume and frequency of the transmission. Hence, they are nothing but rental charges for the equipment/ network installed and made available to the customer and they are rightly described so in section 2.1. The expression rental has therefore special significance and it is only consistent with the nature of the transaction being lease of equipment rather than provision of service. As to the use of expression 'service', it is contended that it is not used in the ordinary sense but it carries an artificial meaning. The services are merely incidental to BT granting right to use or permitting the 'use' of its point to point circuit by the applicant and therefore

the consideration charged partakes the character of 'royalty' as defined in Section 9 of the Act and Article 12(4.a) of the India-USA DTAA.

A reference to various other clauses in the Agreement (Connect Service Schedule) on which reliance is placed by the Revenue, will be given later.

The alternative contention of the Revenue for bringing the payments in question within the definition of 'royalty' is that the applicant has paid for the use of or right to use a process or secret process.

Analysis of agreements :

8. Dell-BT Private Line International Service Schedule and Dell-BT Private Connect Service Schedule were signed by the representatives of Dell-USA, LP and BT America Inc. in June, 2003. It is mentioned in the cover note of both the Service Schedules that the attached terms and conditions, annexures and orders constitute a schedule to the Master Agreement dated 1.1.2003 between British Telecom PIC and Dell-USA, LP and the terms and conditions of the Master Agreement have been incorporated in their entirety in these two schedules between BTA and Dell-USA and in the event of conflict between the terms of the Master Agreement and the Schedule, the latter shall take precedence. As already noted, the applicant has reaffirmed these two agreements and agreed to be bound by the terms and conditions thereof. Basically, the International Service Schedule is in respect of Private Line provided by BTA from Dellas-USA to Bray-Ireland. The Connect Service Schedule relates to the facility from Bray-Ireland to Bangalore, India (vide Foot notes at pg. 3 of each Schedule).

8.1. It may be mentioned at this juncture that according to the Revenue's counsel, it is the Connect Service Schedule that is relevant because it is the one that has nexus with the activities in India and it is under the terms of this Schedule that the payment has been made by the applicant in India. The learned counsel for Revenue even suggested that the comments made by the Department with reference to the terms of International Service Schedule may be ignored as it has no direct nexus with the payments which give rise to the present controversy. The learned Sr. counsel for the applicant while pointing out that both the agreements

(Service Schedules) should be read together in order to understand the nature of the transaction, however, submitted that as suggested by the Revenue's counsel, he would advance the arguments mainly on the basis of the terms of the Connect Service Schedule. Even then, the counsel states, different result would not follow.

8.2. While it is true that CSS is more relevant as it essentially takes care of domestic compartments of Service, the two need not be treated as watertight components. They are inter-connected agreements. Reference to the provisions of ISS wherever necessary is not impermissible.

8.3. To know the scope and essence of each agreement, it is necessary to refer to the service description as given in section 2 of both the Schedules:

2. Service Description

2.1. BT Private Line International services are dedicated, point to point, international links, directly connecting two Customer Sites via digital circuits for the transmission of voice, data and IP traffic.

2.2. The service comprises an end-to-end offering between the Customer Site in Country A and the Customer site in country B.

Further, it is seen from section 2.3. that the service comprises of two components: (i) International Component comprising of the Core Network between the two countries of the Service. (ii) Domestic Component comprising of the Access Lines from Core Network in each country of the service to the Customer Site. Core Network means the core international telecommunications network owned by BTA. 'Network' is defined to mean the telecommunications network provided by BTA comprising hardware, software and private circuits for the purpose of providing the service. It is stated in section 2.4 that "for speeds 1920K and below, conversion is required and BT equipment provided will be chargeable". 2.7 says that "BT equipment remains the property of BT or its agents."

8.4. The 'service description' given in the second Agreement i.e. Connect Service Schedule is the following:

2.1 Overview

BT Private Line Connect Service ("the Service") uses dedicated, digital international point-to-point circuits for the transmission of voice, data, IP and image or combination of any of these. They are permanently available, 24 hours a day, for a fixed rental charge.

Connectivity is provided by a number of physical components – specifically domestic Access Lines in both countries of delivery and the core International Network (made up of under sea cables or satellite capacity).

The Service is a bilateral service and is jointly provided with Distant End TAs giving full country coverage in both countries of delivery. Bandwith speeds are available up to 155 Mbps* (depending on the capability of the Distant End TA).

Section 2.2 deals with ordering, contracting and billing. 2.2.2 provides If for regulatory, licensing or tax reasons a circuit has to be provided directly to the customer by a third party service provider, BT will liaise on behalf of customer with such third party to provide the customer with a single point contact for ordering, billing and fault repairing.

8.5. The definitions of the various terminology employed are the same in both the agreements. 'Access Line' is defined as a private circuit used to connect a Site to the network. The definition of 'network', we have already noted. 'Site' means the customer premises at which BT terminates the service. The customer premises in USA and in India. 'Distant End T.A.' means the distant end telecommunications authority in the distant end country, which is the Partner carrier with whom BT jointly provides the service. 'Distant End Country' means the B-end country of the Service, as detailed in the Order Form.

What is a Circuit?

9. In short, it is the complete path of an electric current, a communication link between two or more points#. One of the meanings given in the Concise Oxford

Dictionary is: "a system of electrical conductors and components forming a complete path or on which an electric current can flow". In McGraw Hill Dictionary on Scientific and Technical Terms, 'Circuit' is described as a complete wire, radio or carrier communications channel".
In 'Chambers Dictionary of Science and Technology' the term is defined as follows:

'Circuit' (Elec.Eng) : Arrangement of conductors and passive and active components forming a path, or paths, for electric current; Circuit (telecom): (1) Complete communication channel. (2) An assembly of electronic (or other) components having some specific function, e.g. amplifier, oscillator or gate.

In McGraw-Hill Concise Encyclopedia of Science and Technology, we get a comprehensive picture of electrical and electronic circuits. Circuit (electricity) is described as a general term referring to a system of conducting parts and their inter-connections through which an electric current is intended to flow. A circuit is made up of active and passive elements or parts and their interconnecting conducting paths. The active elements are the sources of electric energy for the circuit; they may be batteries, direct-current generators, or alternating-current generators.

Circuit (electronics) is stated to be an electric circuit in which the equilibrium of electrons in some of the components is upset by a means other than an applied voltage. ..... . Electronic circuits find application in all branches of industry and in the home, both for entertainment equipment and increasingly for control. Because of their low power dissipation and fast response, they are excellent control circuits. Computers, communication systems, and navigation systems use many types of electronic circuits.

10. Bandwidth is another relevant term which needs to be adverted to. Bandwidth is the difference between the frequency limits of a band containing the useful frequency components of a signal (McGraw-Hill Dictionary of Scientific & Technical Terms). It is a capacity of transmission medium or amount of data,

measured usually in bits per second that can be sent through a dedicated (leased) transmission circuit (Glossary of I.T. terms by Deeksha Agarwala)

CSS - terms and stipulations:

11. As we are directly concerned with Connect Service Schedule and the amounts chargeable thereunder, we shall now refer to the relevant provisions in that Agreement in more detail. Section 3 says that the Service for each Site will commence on the Operational Service Date of that site. Let us then note the BTA's responsibilities and Customer's responsibilities as set out in section 4 and 5 of Connect Service Schedule.

Section 4 details BTA's responsibilities under three heads: (i) Network Management; (ii) Providing a designated Service Centre, and (iii) Fault Repairs relating to (a) Network faults, and (b) Access Line faults.

BT's responsibility as regards item (i) is set out in Section 4.

4.1. Network Management

BT will manage availability of the International Network up to the Distant End International Gateway and manage any failure of the Network so as to restore service as soon as is reasonably practicable. The International Network is managed 24 hours a day 365 days per year.

4.1.1. BT will work with the Distant End TA to provision the International Network and ensure that both half circuits are tuned up at the same time so that the Customer will have an end-to-end service on the Operational Service Date.

International network is defined as "the international telecommunication network jointly owned by BT and Distant End TA terminating at the International Gateways in the U.K. and the Distant End Country". International Gateway means the demarcation point between the International Network and the Access Line. It is mentioned in the order form (Annexure-1) that in country A i.e. India the telecom operator is VSNL and in country B i.e. Ireland, the telecom operator is ESAT BT.

Stipulations regarding fault repairs are found in section 4.3. BT itself will respond to network faults whereas the Access Line faults are attended to in liaison with the local Public Telecommunication Service Provider (PTSP) [vide sec.4.3]. Planned maintenance and Emergency maintenance are provided for under clause 4.7. Among the situations in which the BT has to undertake emergency works, the changes or alterations to the Service or BT equipment made other than by BT or authorized agent is mentioned as one such.

Section 5 of Connect Service Schedule deals with Customer's responsibilities. Section 5.1. says that the customer must provide a CSU/DSU in the US and may have to provide "Customer Equipment at the Distant-End country", and "it is the customer's responsibility to ensure that the Customer Equipment at each site is capable of successful conversion of the signaling systems or protocols that the customer may use." Customer shall report faults in the service to the Service Centre using the fault reporting procedures. The faults diagnosed to be occurring in the Access Line not provided by BT shall be reported directly to the PTSP (vide 5.2). The customers are required to notify the BT service centre of any "Network affecting incidents" such as disconnection of BT equipment (vide 5.4.). Then, Section 5.5. says:

5.5. "The customer shall not, nor allow any person to:

5.5.1. attach anything directly to the Service; or

5.5.2. connect any electrical connection to the Service; or

5.5.3. place or use anything in such a way or position in relation to the Service that it is capable of transmitting or receiving any message or communication to or from the private circuit except in accordance with BT direction and conditions for the attachment of Customer's equipment to BT provided telecommunication systems.

The charges for the Service are as set out in Section 6 of both the Schedules. Where the service is not a tariffed Service, the charges for the use of the service will be in accordance with the prices set forth in the Order form (Annex. I). Clause

6.4 stipulates that the charges for the service will normally comprise some or all of the following components as appropriate:

One-time Charges Monthly Recurring Charges

Access Line Installation

BT Full Channel

*Distant end TA Access

Line installation BT International Half Channel (service from the UK to halfway' to the Distant End Country)

Access Line

*Distant end TA Access Line

* Not mentioned in International Service schedule

There is a note at the end of 6.4 which says: "Access line charges and Partner T.A. half channel charges are priced at current rates that are passed through to customer. Consequently, the prices for such elements are subject to rate changes based on the current local tariffs of the relevant national Public telecom Service Provider". The initial charges for the Service and the additional charges for other optional service features are as per the details given in the order/order form (vide 6.5 & 6.6). It is stated in section 6.7 that recurring charges are based on the country pair and speed of the Service. All withholding taxes and levies imposed outside the US on sums due to BT shall be borne and paid for by the customer in addition to the sums payable to BTA (vide 6.9). The payment terms are specified in section 7. One time installation charges will be invoiced upon the Operational Service Date. Monthly recurring charges will be invoiced upto one month in advance of the month to which the charges relate. Service levels and performance credits are specified in Annex. 2 to the Schedule.

11.1. A perusal of the Order form in Annex. I of the Connect Service Schedule shows that on the date of signing Service Schedule (i.e. June 2003), the monthly rental is shown as 200,100 USD excluding taxes. In the application, the monthly recurring charges are mentioned as 10,000 USD for the circuit between US and Ireland and Rs.83,100 for the circuit between Ireland and India. However, nothing much turns on this apparent discrepancy. In the Order Form, BT network installation charges is shown as waived. Access Line Installation Charge is specified as 12,000 USD. The same is the position in International Service Schedule. Two items which are charged for in the case of International Service Schedule are: (1) Total monthly rental charge 21,200 USD, and (2) Installation charge for B-end access line – 12,000 USD.

11.2. The Service for each site which commences on the 'operational service date' will continue for a minimum period of 12 months or such other period specified in the Order (Annex 1) and even thereafter, the Agreement will continue in force until terminated by either party by giving 60 days' notice (vide Sec.3)

Discussion: Reg. applicability of clause (iv.a) of Expl.2 to S.9(1)(vi):

12. After noting the important features and terms of the Agreements, we shall now proceed to address the crucial question whether the agreement (Connect Service Schedule) contemplates consideration^ to be paid for the use of or right to use the equipment within the meaning of clause (iv-a) of Explanation 2 to Section 9(1)(vi) as well Art. 12(3) of the Treaty. The respective contentions in this regard, we have already noted. The applicant's counsel highlighted the fact that everywhere in the Agreement, the emphasis is on service element and nowhere the user of equipment by the applicant or the grant of rights for such user is contemplated. It is a case of rendition of service by BTA, using its own network and equipment. We find considerable force in the applicant's submission; 'Service' is an unbroken thread running through the entire fabric of agreement between the parties. Even in the clauses specifying the charges and payment terms, the expression used is 'recurring charges'. It is only in clause 2.1 wherein the 'Service Description' is given, the expression 'rental charges' is used and the same expression 'monthly

rental' is repeated in the Order Form. But we have to read the Agreement as a whole and try to harmonize the clauses in the Agreement when differing expressions are used to convey the same idea. The label given to a transaction or the description of jural relationship is not important much less decisive, more so where divergent terms are used in the same Agreement.

12.1. Legally and in ordinary sense, the expression 'rental' denotes the consideration paid in a transaction of lease or hire. Such transaction pre-supposes the transfer of interest in the property or goods. Right to exclusive possession / custody and enjoyment thereof over a stipulated period of time are its necessary attributes. There is nothing in the present Agreement, which indicates that particular equipment has been leased out to the applicant and the applicant has been put in exclusive custody and control thereof. Provision of telecom bandwidth facility by means of dedicated circuits and other network installed and maintained by the BTA or its agent does not, in the absence of specific and clear indication, amount to a lease of equipment. The expression 'rental' used here and there in the Agreement is not used in its legal sense nor can it be treated as a decisive factor.

12.2. Prof. Klaus Vogel# says that "some and particularly older DTCs refer to rentals or similar amounts paid as consideration". But, the phraseology in the India-US Treaty or the provision in the I.T.Act has not employed such restrictive language. Placing reliance on the CBDT$ Circular No.14/2001, it is contended by the applicant that cl.(iv.a) was added to Expl.2 by the Finance Act of 2001 only with a view to bring the leasing transactions within the net of taxation. However, the Circular cannot be construed to have exhaustively defined the scope of cl.(iv.a) In any case, the Circular cannot control the plain language of the said clause.

12.3. The language of cl.(iv.a) pertaining to royalty definition or for that matter, the language in the Treaty cannot be confined to pure and simple lease transactions. The phraseology "the use of or right to use the equipment" is wider in scope and can cover transactions which are not in stricto sensu 'leases'. Transactions falling short of lease and having substantial similarities with lease or hire can also be brought within the sweep of cl.(iv.a) and Art.12(3).

12.4. Has the consideration in the form of monthly recurring charges been paid by the applicant for the use of equipment or for getting a right to use the equipment owned by BTA ? How the expression "use" or right to use" should be understood vis-à-vis the equipment? These are the crucial questions we have to address.

12.5. It seems to us that the two expressions 'use' and 'right to use' are employed to bring within the net of taxation the consideration paid not merely for the usage of equipment in presenti but also for the right given to make use of the equipment at future point of time. There may not be actual use of equipment in presenti but under a contract the right is derived to use the equipment in future. In both the situations, the royalty clause is invokable. The learned senior counsel for the applicant sought to contend, relying on the decision of A.P. High Court in the case of Rashtriya Ispat Nigam Limited (77 STC 182) which was affirmed by the Supreme Court+, that mere custody or possession of equipment without effective control can only result in use of the equipment whereas a right to use the equipment implies control over the equipment. We do not think that such distinction has any legal basis. In the case of RIN, what fell for consideration was the expression "transfer of right to use any goods" occurring in a sales-tax enactment. Obviously, where there is a transfer, all the possessory rights including control over the goods delivered will pass on to the transferee. It was in that context, emphasis was laid on 'control'. The Supreme Court affirmed the conclusion of the High Court that the effective control of machinery even while the machinery was in use of the contractor remained with RIN Ltd. which lent the machinery. The distinction between physical use of machinery (which was with the contractor) and control of the machinery was highlighted. The ratio of that decision cannot be pressed into service to conclude that the right of usage of equipment does not carry with it the right of control and direction whereas the phrase 'right to use' implies the existence of such control. Even in a case where the customer is authorized to use the equipment of which he is put in possession, it cannot be said that such right is bereft of the element of control. We may clarify here that notwithstanding the above submission, it is the case of applicant that, it has neither possession nor control of any equipment of BTA.

12.6. The other case cited by the learned counsel for applicant to explain the meaning of expressions 'use' and right to use' is that of BSNL vs UOI++ . Even that case turned on the interpretation of the words "transfer of right to use the goods" in the context of sales-tax Acts and the expanded definition of sale contained in clause (29-A) of section 366 of the Constitution. The question arose whether a transaction of providing mobile phone service or telephone connection amounted to sale of goods in the special sense of transfer of right to use the goods. It was answered in the negative. The underlying basis of the decision is that there was no delivery of goods and the subscriber to a telephone service could not have intended to purchase or obtain any right to use electro-magnetic waves. At the most, the concept of sale in any subscriber's mind would be limited to the handset that might have been purchased at the time of getting the telephone connection. It was clarified that a telephone service is nothing but a service and there was no sale element apart from the obvious one relating to the handset, if any. This judgement, in our view, does not have much of bearing on the issue that arises in the present application. However, it is worthy of note that the conclusion was reached on the application of the well-known test of dominant intention of the parties and the essence of the transaction.

The word 'use' – what it means:

12.7. Let us now explore the meaning of the key word 'use'. The expression 'use' has a variety of meanings and is often employed in a very wide sense, but the particular meaning appropriate to the context should be chosen. In S.M. Ram Lal & Co. vs. Secretary to Government of Punjab^, the Supreme Court noted that "in its ordinary meaning', "the word 'use' as a noun, is the act of employing a thing; putting into action or service, employing for or applying to a given purpose". In the New Shorter Oxford Dictionary, more or less the same meaning is given. The very first meaning noted there is: "the action of using something; the fact or state of being used; application or conversion to some purpose". Another meaning given is "Make use of (a thing), especially for a particular end or purpose; utilize, turn to account..... cause (an implement, instrument etc.) to work especially for a particular purpose; manipulate, operate". The various shades of meanings given in

the decided cases in America are referred to in Words and Phrases, Permanent Edition Vol.43A. Some of them are quoted below:

"The word 'use' means to make use of; convert to one's service; to avail oneself of; to employ". (Miller vs.Franklin County)
"The word 'use' means the purpose served, a purpose, object or end for useful or advantageous nature". (Brown vs. Kennedy)

'Use' means to employ for any purpose, to employ for attainment of some purpose or end, to convert to one's service or to put to one's use or benefit. (Beach vs. Liningston)

"Use", as a noun, is synonymous with benefit and employment and as a verb has meaning to employ for any purpose, to employ for attainment of some purpose or end, to avail one's self, to convert to one's service or to put to one's use or benefit". (Esfeld Trucking Inc. vs. Metropolitan Insurance Co.)

12.8. The word 'use' in relation to equipment occurring in (iv.a) is not to be understood in the broad sense of availing of the benefit of an equipment. The context and collocation of the two expressions 'use' and 'right to use' followed by the words "equipment" suggests that there must be some positive act of utilization, application or employment of equipment for the desired purpose. If an advantage is taken from sophisticated equipment installed and provided by another, it is difficult to say that the recipient/customer uses the equipment as such. The customer merely makes use of the facility, though he does not himself use the equipment.

13. It is the contention of the Revenue that dedicated private circuits have been provided by BTA through its network for the use of the applicant. The utilization of bandwidth upto the requisite capacity is assured on account of this. The electronic circuits being 'equipment' are made available for constant use by the applicant for transmission of data. The access line is installed for the benefit of the applicant. Therefore, the consideration paid is towards rent for circuits and the physical components that go into the system. It is further contended that rendition

of service by way of maintenance and fault repairs is only incidental to the dominant object of renting the automated telecommunication network.

13.1. There is no doubt that the entire network consisting of under-sea cables, domestic access lines and the BT equipment – whichever is kept at the connecting point, is for providing a service to facilitate the transmission of voice and data across the globe. One of the many circuits forming part of the network is devoted and earmarked to the applicant. Part of the bandwidth capacity is utilised by the applicant. From that, it does not follow that the entire equipment and components constituting the network is rented out to the applicant or that the consideration in the form of monthly charges is intended for the use of equipment owned and installed by BTA. The questions to be asked and answered are: Does the availment of service involve user of equipment belonging to BT or its agent by the applicant? Is the applicant required to do some positive act in relation to the equipment such as operation and control of the same in order to utilize the service or facility? Does the applicant deal with any BT equipment for adapting it to its use? Unless the answer is 'yes', the payment made by the applicant to BTA cannot be brought within the royalty clause (iv.a). In our view, the answer cannot be in the affirmative. Assuming that circuit is equipment, it cannot be said that the applicant uses that equipment in any real sense. By availing of the facility provided by BTA through its network/circuits, there is no usage of equipment by the applicant except in a very loose sense such as using a road bridge or a telephone connection. The user of BT's equipment as such would not have figured in the minds of parties. As stated earlier, the expression 'use' occurring in the relevant provision does not simply mean taking advantage of something or utilizing a facility provided by another through its own network. What is contemplated by the word 'use' in clause (iv.a) is that the customer comes face to face with the equipment, operates it or controls its functioning in some manner, but, if it does nothing to or with the equipment (in this case, it is circuit, according to the Revenue) and does not exercise any possessory rights in relation thereto, it only makes use of the facility created by the service provider who is the owner of

entire network and related equipment. There is no scope to invoke clause (iv.a) in such a case because the element of service predominates.

13.2. Usage of equipment connotes that the grantee of right has possession and control over the equipment and the equipment is virtually at his disposal. But, there is nothing in any part of the Agreement which could lead to a reasonable inference that the possession or control or both has been given to the applicant under the terms of the agreement in the course of offering the facility. The applicant is not concerned with the infrastructure or the access line installed by BTA or its agent or the components embedded in it. The operation, control and maintenance of the so-called equipment, solely rests with BTA or its agent being the domestic service provider. The applicant does not in any sense possess nor does it have access to the equipment belonging to BTA. No right to modify or deal with the equipment# vests with the applicant. In sum and substance, it is a case of BTA utilizing its own network and providing a service that enables the applicant to transmit voice and data through the media of telecom bandwidth. The predominant features and underlying object of the entire agreement unerringly emphasizes the concept of service. The consideration paid is relatable to the upkeep and maintenance of specific facility offered to the applicant through the BTA's network and infrastructure so that the required bandwidth is always available to the applicant. The fact that the international circuit as well as the access line is not meant to offer the facility to the applicant alone but it enures to the benefit of various other customers is another pointer that the applicant cannot be said to be the user of equipment or the grantee of any right to use it. May be, a fraction of the equipment in visible form may find its place at the applicant's premises for the purpose of establishing connectivity or otherwise. But, it cannot be inferred from this fact alone that the bulk of consideration paid is for the use of that item of equipment.

13.3. In cases where the customers make use of standard facility like telephone connection offered by the service provider, it does not admit of any doubt that the customer does not use the network or equipment of the service provider. But, where the service provider, for the purpose of affording the facility, has provided

special infrastructure/network such as a dedicated circuit (as in the instant case), controversies may arise as to the nature of payment received by the service provider because it may not stand on the same footing as standard facility. However, even where an earmarked circuit is provided for offering the facility, unless there is material to establish that the circuit/equipment could be accessed and put to use by the customer by means of positive acts, it does not fall under the category of 'royalty' in clause (iv.a) of Explanation 2.

13.4. The Counsel for the Revenue has relied on certain clauses in the agreement to substantiate his contention that the applicant has custody of and access to network/equipment. Section 5.5 prohibits the customer from attaching anything directly or indirectly to the service. The customer cannot also place or use anything in relation to the service in such a way or position that it is capable of transmitting or receiving any communication to or from the private circuit except in accordance with BT's direction and conditions for the attachment of Customer's equipment. Far from supporting the Revenue's case, these stipulations go against it. Reliance was then placed on the clauses in Annexure 1 (Service Levels for Connect Service Schedule). Clause 5 deals with 'Exclusions'. Clause 5.1 explains as to when the unavailable time, which means a break in transmission, will not be counted in favour of the customer for calculating the rebate. Among these, the access line being modified or altered in any way either "at the customer's request or by the customers themselves" is an exclusion provided in clause 5.1. From this, it is sought to be inferred that the customer (applicant) is in a position to modify the equipment and that the agreement recognizes this fact. We cannot construe this provision as a sort of licence given to the applicant to modify or meddle with the access line or the equipment. In fact, section 5.5 referred to supra, gives a contra indication. Clause 5.1 (a) of Annexure 2 reinforces the prohibition contained in section 5.5 by penalizing the applicant with higher charges. That is the underlying object of this provision. The counsel for Revenue then drew our attention to clause 3.4 of Annexure 2, which according to him, is another pointer that the applicant is in custody of the circuit and equipment, and that it uses the same for the purpose of transmission of voice and data. Clause 3.4 states that BT will require "full

access to the circuit during the course of fault investigation and fault repairs" including access to the customer's premises. It does not mean, as the Revenue's counsel wants to contend, that BTA or its agent has no access otherwise to the circuit/equipment as it is placed at the disposal of the applicant. We do not think that so much can be read into clause 3.4. By this clause, BTA is reiterating its authority which it has in any case to check the circuit and to restore a non-functional circuit, if necessary by entering the customer's premises.

13.5. It seems to us that the passage quoted by the applicant's counsel from Prof. Klaus Vogel's commentary on Double Taxation Convention brings out the distinction between the rendering of service by a person using his own equipment vis-à-vis the grant of the right to use the equipment to the recipient of service. It is stated : "..... ,the use of a satellite is a service, not rental; this would not be the case only in the event that the entire direction and control over the satellite such as piloting, steering were transferred to the user" (at page 802). The proposition though stated too broadly, does furnish guidance in understanding the scope of the relevant royalty clause.

13.6. Counsel for the applicant has drawn our attention to the decision of Madras High Court in Skycell Communication Ltd. vs. DC of Income-tax& and the decision of ITAT (Banglore Bench) in Wipro Limited vs. ITO(ITA No.991/2002) and sought to derive support from these decisions. The first one relates to mobile telephone facility provided to the subscribers. The High Court held that technical service referred to in section 9(1)(vii) contemplates rendering of a service to the payer of the fee. Mere collection of a 'fee' for use of a standard facility does not amount to a receipt for technical service. We are not concerned here with the clause relating to the fees for technical service. The ratio of that decision cannot be applied here. The case of Wipro, though closer to the facts of the present case did not consider the applicability of clause (iv.a) of Explanation 2 to section 9(1)(vi).

13.7. The applicant's counsel then relied on the definition of 'leased circuit' in Section 65 (60) of the Finance Act, 1994. It is defined as "dedicated link between two fixed locations for exclusive use of the subscriber and includes the speech

circuit, data circuit or telegraph circuit. The term taxable service includes "any service provided or to be provided to a subscriber by the Telegraph Authority in relation to the leased circuit" (vide section 65 (105)(zb). Relying on these provisions, the counsel for the applicant contends that even under the service tax Law, the provision of bandwidth connectivity is considered as a 'leased circuit' service liable for service tax. It is not necessary to delve into the larger question whether service tax provisions can be pressed into service for understanding the real nature of transaction in the instant case.

13.8. We have approached the entire issue only from the angle whether the applicant can be said to have used the alleged equipment or obtained the right to use it. An equally relevant question would be whether any equipment has been placed in the possession and control of the applicant. Though the Revenue and its counsel asserts that electronic circuit is tangibly an equipment, no arguments were advanced to substantiate this point. Even the applicant, either in written or oral submissions has not dealt with this aspect, except by way of bald repudiation of the Revenue's contention. In this background, we do not propose to deal with this point. The conclusion that there was no use or right to use (the equipment) is sufficient to answer the issue as regards the applicability of clause (iv-a) of Explanation 2 in favour of the applicant.

14. Whether the payment made by the applicant to BTA is in the nature of royalty falling under clause (iii) of Explanation 2 and/or Article 12(3) of the Treaty?$

14.1. It is one of the contentions of the Revenue that the applicant makes use of or is conferred with the right to use a 'process' within the meaning of clause (iii) to Explanation (2) to Section 9(1) of the Act. That clause speaks of "the use of any patent, invention, model, design, secret formula or process or trade mark or similar property". It is contended, relying on the decision of ITAT in the case of Asia Satellite Telecommunications Company Ltd. vs. Deputy Commissioner of IT (ITA No.166/DEL/2001* dated 1.11.2002) that the word 'secret' only qualifies the expression 'formula' and cannot be read before the word 'process'. On such interpretation, it is submitted by the Revenue in its comments that the services

provided to the applicant are clearly in the nature of a process and not in the nature of standard facility and the applicant has used and has been conferred with the right to use such process. However, this contention has not been urged before us by the learned Counsel for the Department for the obvious reason that the language used in the relevant clause of the Treaty does not support any such interpretation. The expression in Article 12(3) (referred to at para 7.1 supra) is "for the use of or the right to use any copyright, patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience." It is thus clear that formula/process are part of the same group and the adjective 'secret' governs both. The reasoning of ITAT in the aforementioned case, based on the absence of comma after process and the impact of the immediately following word, 'trade mark', does not hold good in view of the clear language in Article 12(3) of the Treaty. It has been so pointed out very rightly by another Bench of ITAT in Panamsat International Systems Inc. vs. Dy. Commissioner Income-tax (ITA. No.1796/DEL/2001 dated 11.8.2006) at paragraph 6.18. Going by such interpretation, it cannot be held that there is, in the instant case, the use of or the right to use a secret process. In fact it is nobody's case that any secret process is involved here and the applicant makes use of it. The use of secret process is alien to the minds of contracting parties. Incidentally, we may mention that it was brought to our notice that similar bandwidth services through private circuits are being provided by many other telecom operators. Hence, the royalty definition under the Treaty relating to secret process is not attracted here. We may mention that the applicant contended that the decision of ITAT in Asia Satellite case (supra) is distinguishable on facts. It is unnecessary to deal with this aspect.

Questions 1 and 3:

15. Whether the amounts payable by the applicant under the agreement would be in the nature of 'fee for included services" within the meaning of Article 12(4) of the Treaty OR 'fee for technical services' within the scope of clause (vii) of Explanation 2 to section 9(1) of the Income-tax Act, 1961. These questions need not be discussed at length because it has been fairly and correctly stated by the

Revenue and its counsel that the requirement in article 12(4) of the Treaty that technical knowledge, experience, skill, etc. should be made available has not been satisfied in the instant case. In view of such language, the ambit of technical service has been considerably reduced in scope. The phrase "make available" occurring in 12(4) has been clarified in the MOU to the Treaty itself to the situations where the person receiving the service is enabled to apply the technology. As there is no transfer of any technology in the sense that the recipient of the service is enabled to apply technology by itself, the payment does not constitute a fee for included service, as clarified in para 6 of the comments dated 6.10.2006. When once the applicant gets the advantage of Treaty provision, there is no need to enter into a discussion on the applicability of the relevant provision of the Income-tax Act, 1961.

15.1. Accordingly, the first question is answered in the negative to the effect that the payments are not in the nature of 'fee for included services' under Article 12(4) of the Treaty. In view of this conclusion, the third question need not be answered.

Question No.5:

16. Sub clause (b) of clause (vi) of section 9 carves out an exception' to the taxability of royalty paid by a resident. According to the 'exception', the royalty payable in respect of any right, property or information used or services utilised (a) for the purpose of business or profession carried out by such person outside India OR (b) for the purpose of making or earning any income from any source outside India is not an income that falls within the net of section 9. The applicant is relying on the second part of the exception i.e. "for the purposes of making or earning any income from any source outside India". It is the case of the applicant that its business principally comprises of export revenue in the sense that it provides data processing and information technology support services to its group companies abroad and receives payment in foreign exchange against such exports. Therefore, although its business is carried out from India, the income it gets is from a source outside India and the payment it makes to BTA is for the purpose of

earning income from a source outside India. Hence, according to the applicant, the benefit of exception envisaged by section 9(1)(vii)(b) will be available to it. In the context of this argument, it is pointed out by the learned Counsel for the applicant that the two limbs of clauses (a) and (b) supra are distinct and the mere fact that the business is carried on in India and not outside India does not come in the way of invoking the exception provided by the latter limb, i.e., for the purpose of earning income from a source outside India. We find it difficult to accept the applicant's contention. No doubt, the factum of the applicant carrying on business in India does not come in the way of getting the benefit of the exception. It is possible to visualize the situations in which the business is carried on principally in India whereas a particular source of income is wholly outside India, but, that is not the situation here. The income which the applicant earns by data processing and other software export activities cannot be said to be from a source outside India. The 'source' of such income is very much within India and the entire business activities and operations triggering the exports take place within India. The source which generates income must necessarily be traced to India. Having regard to the fact that the entire operations are carried on by the applicant in India and the income is earned from such operations taking place in India, it would be futile to contend that the source of earning income is outside India i.e. in the country of the customer. Source is referable to the starting point or the origin or the spot where something springs into existence. The fact that the customer and the payer is a non-resident and the end product is made available to that foreign customer does not mean that the income is earned from a source outside India. As aptly said by Lord Atkin in Rhodesia Metals Ltd. vs. Commissioner of Taxes** "source means not a legal concept but something which a practical man would regard as a real source of income."

16.1. The applicant's counsel has placed reliance on the decision of Income Tax Appellate Tribunal in Synopsis India Pvt. Ltd. Vs. ITO Bangalore* and that of the Madras High Court in CIT vs. AK Kopp and Causch, W Germany@ In the case of Synopsis India Ltd., the assessee made payments to a foreign company which provided down-linking service to the assessee in connection with

the transmission of data through satellite communications. The Tribunal found that the entire turn over of the company was export of software devices / products for which international connectivity was provided by a US company Datacom-Inc. The Tribunal held that the assessee, though carried on business in India, earned income from the sources outside India and the payments made to Datacom-Inc. was to earn income from a source outside India. The Tribunal apparently relied on two factors (i) the entire turn over of the assessee company is derived from export of software (ii) such export activity was undertaken after "obtaining the data from international connectivity". There is no reasoned discussion on the point whether the source of income was located outside India. The Tribunal proceeded on the premise that in the given set of facts the income was derived from sources outside India. In the second case, the Madras High Court found that the royalty was paid out of export sales and therefore the source for royalty was the sales outside India. It was on such finding of facts that the conclusion was drawn. The ratio of this decision also cannot be applied to the present case.

16.2. There is another angle from which the issue can be approached. The network of telecommunication facility availed of by the applicant for the purpose of two way transmission of voice and data is not for the avowed purpose of making or earning income from a source outside India. Nothing precludes the applicant from making use of the facility it secured for the purpose of its business in India. That is why the applicant has guardedly used the words that the applicant "is inter alia, engaged in the business of providing call centres and data processing and information technology support services to its group companies" and at another place, the expression used is "principally comprises of export revenues" (emphasis supplied). No material has been placed before us to show that the network is not being availed of and not meant to be availed of for doing similar business within the country. It cannot therefore be said that the payments made to BTA for establishing and maintaining the requisite telecommunication network is for the purpose of earning income from a source outside India only. Another hurdle that comes in the way of the applicant is that it cannot be said with certainty that the transfer had taken place outside India. The property could have very well passed

in India even though the terminating point of export is in a foreign country. We have no material in this regard to come to a definite conclusion.

Question No.7: (Re: Permanent Establishment)

17. The Revenue pleaded that having regard to the nature of service and certain clauses in the Agreement (esp. Private Line International Service Schedule) there is every possibility of a fixed place of business of BTA at a particular geographical location in India, notwithstanding the self-serving statement of BTA to the contra. After the arguments were addressed before us, we felt it necessary to call for a report from the Department after making local inspection to bring out the relevant facts having bearing on the existence or otherwise of P.E. of BTA in India. A speaking order to this effect was passed on 12th December, 2007 to pave way for inspection and report.

17.1. The DIT (Intl. taxation) in his turn called for certain information from the applicant and also made certain enquiries with VSNL. We have referred briefly at para 5 above to some facts gathered as a result of these inquires. The applicant in its letter dated 7.2.2008 addressed to the ITO Ward 1(1), International Taxation, Bangalore, expressed its inability to produce any documents relating to inter-se arrangement between BTA and VSNL or other third party service provider in India. The applicant has also not furnished any details about the equipment or BTA or of the domestic service provider at Dell's premises in Bangalore. However, the applicant has stated in its communication dated 4.1.2008 addressed to the ITO that "no equipment or machinery of M/s BTA Inc. or M/s. VSNL or any other independent telecom service provider is installed in Dell premises in USA or in India". But, they have not clarified as to how the connectivity with the access line is established at the site. At the resumed hearing which took place on 7th March, 2008 for the purpose of hearing the applicant on this limited question, the learned counsel for the applicant made it clear that the applicant was not in a position to obtain any further information from BTA and the question of existence of PE may, therefore, be kept open for decision by the appropriate authority. In this background, we are not in a position to give any finding on the point of existence of PE. We are, therefore, not expressing any opinion on this point. In

fact, both the counsel agreed that this question may be left open for determination by the appropriate authority.

Questions 6 and 8: (Relief)

18. The applicant has stated that the payment to BTA is net of any Indian taxes including withholding taxes and it appears to be so under the terms of the agreement. Under section 195A if under an agreement or other arrangement the tax chargeable on any income is to be borne by the buyer, for the purpose of deducting tax at source, such income needs to be increased to an amount equivalent to the net amount payable after deducting tax at source. It implies that the income has to be grossed up for the purpose of deducting the tax.

18.1. Now, the questions framed give rise to twin aspects: (i) the future obligation of the applicant to deduct and pay the income-tax as per the requirements of section 195 and 195-A of I.T.Act and (ii) refund of the tax deducted and paid already.

18.2. These questions would have been answered straight away in favour of the applicant but for the fact that the issue regarding Permanent Establishment still lingers. Unless the concerned authority decides the same in an appropriate proceeding under the Income-tax Act, 1961, the applicant will not be in a position to deviate from the previous practice of deducting tax and to get the relief which could have otherwise flown from this ruling. However, it is open to the applicant to take resort to sub-sections (2) and (3) of section 195 or other relevant provision of I.T. Act and seek a determination by the authority concerned in the light of this ruling. Any such application has to be disposed of most expeditiously. Assuming that in regard to the P.E., an adverse finding is warranted against the applicant, still the applicant has legitimate right to insist that only a portion of the profits attributable to the operations of the P.E., if any, that can be subjected to tax. This principle ought to be kept in mind by the competent authority while determining the quantum of tax if any that has to be withheld and paid. We would like to make it clear that even if the finding as regards existence of P.E. is recorded against the applicant, it does not follow that the entirety of the payments to BTA shall be

regarded as business income. Depending on the nature and function of P.E., the appropriate proportion of profits should be taxed. As regards tax already paid, it is open to the applicant to seek refund/adjustment of tax tentatively paid under s.195 in an appropriate proceeding before the assessing officer in accordance with law.

Ruling:

19. In the result, the answers to various questions (at para 6 supra) are as follows:

Question 1: Answered in the negative. Payment is not liable to be treated as fee for included services within the meaning of Article 12 of the Treaty.

Questions 2 & 4: Answered in the negative. Not royalty within the meaning of the term in Article 12 of the Treaty or Explanation 2 to clause (vi) of section 9(1) of the Income-tax Act, 1961.

Question 3: No need to give ruling in view of the answer to question No.1.

Question 5: Answered in the negative and against the applicant. The exception carved out in sub-clause (b) of clauses (vi) & (vii) of section 9(1) cannot be invoked by the applicant.

Question 7: The issue relating to P.E. is left open for determination in appropriate proceeding.

Questions 6&8: The applicant should approach the appropriate authority under the relevant provisions of I.T.Act and such authority shall decide the applicant's claim most expeditiously keeping in view the observations made in this Ruling. Accordingly, the ruling is pronounced on 18th day of July, 2008.

Sd/- Sd/-

Sd/-

(A. SINHA) (P.V. REDDI) (RAO RANVIJAY SINGH)

MEMBER

CHAIRMAN MEMBER

F.No.AAR/735/2006 Dated.....

The copy is certified to be a true copy of the Ruling and is sent to:

1. The applicant.
2. The Commissioner of Income-tax (International Taxation), Bangalore.
3. The Joint Secretary, (FT&TR-I & II), C.B.D.T, New Delhi.
4. Guard file.

(Batsala Jha Yadav)
Addl. Commissioner of Income