Tax Insights

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Interconnectivity charges received by a non-resident telecom operator from an Indian telecom service provider not taxable as 'royalty' as per the Act and the India-Spain DTAA – Bangalore bench of the Tribunal

In brief

Relying on various High Court and Income-tax Appellate Tribunal (Tribunal) rulings, the Bangalore bench of the Tribunal reaffirmed[1] the view that interconnectivity charges received by a non-resident telecom operator from an Indian telecom service provider will not be considered as 'royalty' income as per the provisions of the Income-tax Act, 1961 (the Act) and the India-Spain Double Taxation Avoidance Agreement (DTAA).

In detail

Background

- The taxpayer, a tax resident of Spain, is engaged in providing telecommunication, interconnection, internet services, etc. The taxpayer entered into interconnection agreements with other telecom operators in India to enable seamless service of carrying and/ or delivering outbound and inbound calls.
- Pursuant to the said agreements, the taxpayer received interconnectivity charges (IUC) from the Indian telecom operators during assessment years (AYs) 2010–11, 2011–12 and 2012–13.
- The taxpayer considered the above IUC charges as not chargeable to tax. Based on this opinion, the taxpayer did not file return of income in India for the concerned AYs under consideration.
- While passing the final assessment orders for the above AYs, the Tax Officer treated the IUC charges received by the taxpayer as royalty income being subject to tax at 10%.

Issue before the Tribunal

- Whether the IUC charges received by the taxpayer will be taxable as 'royalty income' in the hands of the taxpayer?

[1] [IT(IT)A No. 2657/Bang/2019, 180/Bang/2021 & 817/Bang/2022]

Taxpayer's contentions

Taxability of IUC charges as FTS

- Relying on the Delhi bench of the Tribunal's ruling in the case of Bharat Sanchar Nigam Limited[2], it was contended that the services rendered by the taxpayer are standard telecom services which are automated and do not require any human intervention. Hence, they cannot be considered as fees for technical services (FTS).

- This issue was settled by the judgment of the Karnataka High Court in the case of Vodafone South[3], wherein it was held that the payment made by a telecom company to another telecom company for utilisation of roaming mobile data and connectivity could not be termed as FTS, and therefore, no tax at source was deductible. The Delhi High Court also followed the said decision in the case of Tata Teleservices Limited[4].

Taxability of IUC charges as royalty

- This issue was settled by the judgment of the Karnataka High Court in the case of Vodafone Idea[5], wherein it was held that payments made to non-resident telecom operators by resident telecommunication service providers for providing interconnect services were not chargeable to tax as 'royalty' income.

Tribunal's ruling

Taxability of IUC charges under the provisions of the Act

The term 'process', referred to in clauses (i), (ii) and (iii) of Explanation 2 to section 9(1)(vi) of the Act, which contains the definition of 'royalty', does not imply any 'process' which is publicly available; rather, it means a 'process' which is an item of intellectual property.

In the instant case, there is no transfer of intellectual property rights or exclusive rights by the taxpayer to the service recipients; hence, Explanation 2 to section 9(1)(vi) of the Act cannot be invoked.

Even after the retrospective insertion of Explanations 5 and 6 to section 9(1)(vi) of the Act, *vide* Finance Act, 2012, the requirement of successful exclusivity of such right in respect of such process being with the person claiming 'royalty' has not been done away with.

Referring to several Authority for Advance Ruling (AAR) orders[6], the Bangalore bench of the Tribunal opined that to satisfy the phrase 'use or right to use', the control and possession of right, property or information should be with the payer.

Relying on the ruling of the Delhi bench of the Tribunal in the case of Bharti Airtel[7], the Tribunal concluded that the IUC charges received by the taxpayer was not covered within the ambit of 'royalty' in terms of Explanations 5 and 6 to section 9(1)(vi) of the Act.

Taxability of IUC charges under the India-Spain DTAA

The definition of 'royalty' provided in the India-Spain DTAA is much narrower than the definition contained in the Act.

In the instant case, sophisticated equipment is installed and operated with the view to earn income by allowing the users to avail the benefits of such equipment and do not amount to granting the 'use or the right to use' the

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2 Bharat Sanchar Nigam Limited *v.* ACIT [ITA No. 920 of 2017]

3 CIT *v.* Vodafone South Limited [ITA No. 699 to 706 of 2015]

4 CIT *v.* Tata Teleservices Limited [ITA No. 1417 of 2018]

5 Vodafone Idea Limited *v.* DDIT [ITA No. 160 of 2015]

6 Cable & Wireless Networks India (P.) Limited, *In re* [AAR No. 786 of 2008 dated 30 June 2009], ISRO Satellite Centre [ISAC], *In re* [AAR No. 765 of 2007 dated 22 October 2008], Dell International Services India (P.) Limited, *In re* [AAR No. 735 of 2006 dated 18 July 2008]

7 Bharti Airtel Limited *v.* ITO [ITA No. 3593 to 3596 and 4076 to 4079 of 2012]

equipment or process so as to be considered within the definition of 'royalty' as contained in Article 13(3) of the India-Spain DTAA.

Additionally, at no point of time is any possession or physical custody, control or management over any equipment received by the end users. The process involved in providing the services to the end users is not a 'secret', but a standard commercial process followed by industry players. Thus, the said process also cannot be classified as a 'secret process', as is required by the definition of 'royalty' mentioned in Article 13(3) of the India-Spain DTAA.

Others

Relying on the judgment of the Karnataka High Court in the case of Vodafone Idea[5], the Tribunal concluded that interconnectivity charges received by the taxpayer cannot be considered as royalty or FTS under sections 9(1)(vi) or 9(1)(vii) of the Act and the India-Spain DTAA.

The payment received by the non-resident taxpayer amounts to business profits which are taxable in the resident country and are not taxable in India under Article 5 of the India-Spain DTAA, as the Revenue Department has not made out any case of permanent establishment of the taxpayer.

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