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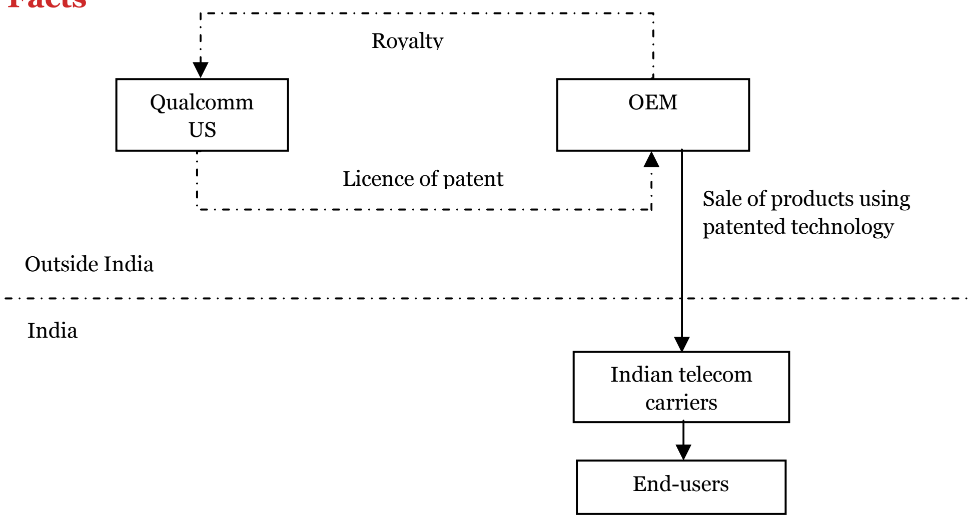
Royalty payment for use of licensed patent technology by a non-resident to another non-resident not taxable

In brief

Recently, in the case of Qualcomm Incorporated[1] (the assessee or Qualcomm US), the Delhi Income-tax Appellate Tribunal (Tribunal) held that royalty paid by a non-resident to other non-resident for use of patented technology in connection with manufacture of handsets and network equipment is not taxable under section 9(1)(vi)(c) of the Income-tax Act, 1961 (the Act), if the patent is exploited outside India.

Facts



[1] Qualcomm Incorporated *v.* ADIT [TS-35-ITAT-2013(DEL)]

- The assessee incorporated in USA, is engaged in the development and licensing of code division multiple access technology (CDMA). It licenses its patents to original equipment manufacturers (OEMs) who are situated outside India and are not residents of India. The OEMs use the patents to manufacture handsets and network equipment (the products) outside India. The OEMs sold the products to wireless carriers worldwide.

- Royalty was payable by the OEMs to Qualcomm US for the use of patented technology in manufacturing the products. It was determined with reference to the net selling price of the products sold to unrelated wireless carriers worldwide. The OEMs typically paid a lump sum royalty on one or more instalments and ongoing royalties based on their sale of products.

- The OEMs sold products manufactured using the patented technology outside India and also to Indian telecom carriers (Indian carriers). The latter, in turn, sold the products to end-users in India.

- The assessing officer (AO) observed that the issue here was not to tax the royalty arising out of the global contract between Qualcomm US and OEMs, but only so much of the royalty which pertained to sales made in India. The AO pointed out that it was not a case, where the royalty has been paid lump sum but was an ongoing payment dependent on the volume of sales. In this case, unless the OEM has raised a bill or shipped the goods to a party in India, no royalty will be payable to Qualcomm US.

- Further, the Commissioner of Income-tax (Appeals) (CIT(A)) upheld the order of AO and held that in addition to the handsets, the AO failed to tax royalty income earned by the assessee on CDMA network equipment.

Issue before the Tribunal[2]

Whether the royalty income earned by Qualcomm US from the OEMs situated outside India can be brought to tax under section 9(1)(vi)(c) of the Act and Article 12(7)(b) of Double Taxation Avoidance Agreement (tax treaty) between India and USA.

Assessee's contentions

- In case of a non-resident, the burden is on the revenue to prove that the royalty is payable under section 9(1)(vi)(c) of the Act.

- The assessee contended that CDMA patents were used for manufacturing CDMA products outside India and that sale was a subsequent event. The agreements are not specific to India. The OEMs manufactured the handsets and equipment using the patents of Qualcomm US and could sell the product anywhere in the world.

- The source of income for Qualcomm US is the agreement with the licensee alone and that this agreement had no reference to India. In the present case, the right, property or information licensed to the OEMs relates to manufacture of the products. Hence, the source is the activity of manufacturing outside India.

- The provisions of section 9(1)(vi)(c) of the Act were not attracted since the right, property or information licensed by Qualcomm US to OEM has been used by the OEM in its business of manufacturing which was undisputedly carried on outside India.

[2] Other grounds of appeal raised in the appeal/ order are not covered by this alert

- The assessee placed reliance on Ishikawajima Harima Heavy Industries Limited[3] and Ericsson AB[4] which held that if the property in the goods passes abroad, no part of the sale proceeds can be taxed in India.

- Further, the assessee contended that limb (i) of section 9(1)(vi)(c) covers cases where the right property or information has been used by OEM itself and is so used in a business carried on by OEM's in India.

- Limb (ii) of the section covers a case where the right property or information has not been used by OEM itself in the business carried on by it, but the right property or information has been dealt with in such a manner as would result in earning or making income from a source in India.

Revenue's contentions

- The revenue emphasised that the language mentioned in section 9(1)(vi) is 'used for the purpose of'. The property may be used anywhere in or outside India, but the use should be for the purpose of business or profession carried on in India and for the purpose of earning income from a source in India.

- The test is to determine whether the property has been used by OEMs 'for the purpose of carrying on business in India' in terms of section 9(1)(vi)(c) and that it is not necessary to look at the arrangements between Qualcomm US and OEMs.

- OEMs were not only supplying the equipment but they were licensing the software, the ownership of which is not transferred to operators in India. Thus, the intellectual property for which the payment is made by OEMs to Qualcomm US is licenced for use in India which yields the income and becomes a source of income for OEMs.

[3] Ishikawajima Harima Heavy Industries Ltd *v* DIT [2004] 288 ITR 408 (SC)
[4] DIT *v.* Ericsson AB [2011] 246 CTR 422 (Delhi)

Tribunal ruling

- The Tribunal accepted the contention of the assessee that the burden is on the revenue to prove that the royalty is payable under section 9(1)(vi)(c) of the Act. The Tribunal also agreed with contention of the assessee as given above for limb (i) and limb (ii) of section 9(1)(vi)(c) of the Act.

- The Tribunal held that what is important is not whether right to property is used 'in' or 'for the purpose of' a business, but to determine whether such business is 'carried on by such person in India'. Technology for manufacturing products is different from products which are manufactured from the use of the technology for which Qualcomm US has patents. The role of Qualcomm US ends when it licensed its patents on IPR's pertaining to CDMA products for manufacture and when it collects royalty from OEM on these products. There is no activity for Qualcomm US after this sale and shipment.

- The title in the goods in the assessee's case has passed outside India as per the clauses in the agreement. OEMs have not carried on business in India, and that the OEMs cannot have used Qualcomm US patents for the purpose of such business in India. A sale to India without any operations being carried out in India would amount to business with India and not business in India.

- The Tribunal held that the propositions held in the case of Motorola Inc[5] in relation to the title of the GSM equipment having passed outside India would equally apply to the facts of this case. To tax the royalty income earned by the assessee, the revenue must show that the OEMs have used Qualcomm's patents for a business carried on in India or for making or earning income from a source in India, which leads to the taxability of the OEMs. The taxability of Qualcomm US directly depends on the OEMs taxability in India.

[5] Motorola Inc *v.* DCIT [2005] 95 ITD 269 (Del)(SB) affirmed by Delhi High Court in DIT *v* Ericsson AB [2011] 246 CTR 422 (Delhi)

When OEM's itself are not brought to tax, to hold that Qualcomm US is taxable does not hold good.

- The Tribunal observed that in view of the specific clauses in the agreement, it is clear that the software does not have an independent use and is an integral part of the hardware without which the hardware cannot function. The software supplied was a copyrighted article and not a copyright right. Applying the propositions laid down by the high court in the case of Ericsson AB (above)/Nokia Networks OY[6] the income from embedded software cannot be taxed in India.

- It concluded that the revenue had not proved that the OEMs have carried on the business in India and that they have used Qualcomm US patents for carrying on such business in India nor the revenue has proved that the OEMs have used Qualcomm US patents for the purpose of making or earning income from a source in India. Thus, the royalty in question cannot be brought to tax under section 9(1)(vi)(c) of the Act.

- Finally, the Tribunal held that the applicability of Article 12(7)(b) of the India-US tax treaty would be academic, having held that the amount is not taxable under the Act.

Conclusion

- This ruling provides a detailed understanding on applicability of section 9(1)(vi)(c) of the Act in connection with income arising by way of royalty for non-residents.

- This ruling holds that it is for the revenue to prove that royalty is payable under section 9(1)(vi)(c) of the Act.

- The ruling links taxability of OEMs and software license owners in India by holding that if the OEMs are not taxable the licensors cannot be taxable for the same sale.

[6] DIT *v.* Nokia Networks OY [TS-700-HC-2012(DEL)]

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