Royalty and Fees for Technical Services (FTS)

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1. Introduction

This is the fifth article in the series of taxation of Non-Residents. In the current article we will cover the provisions of taxation of Royalty and FTS earned by a non-resident in India. With increased globalization and the growth of information technology, the import of technical know-how, acquisition of software and technical services is not very uncommon in developing economies like ours, therefore one must be privy with the taxation provisions for Royalty and FTS.

As highlighted in the previous articles, we know that a non-resident is liable to tax in India on that income which is chargeable to tax in India. Income of a Non Resident is chargeable to tax in India if–

i. It is received in India; or deemed to have been received in India
ii. It accrues or arises in India or is deemed to accrue or arise in India.

Non resident is entitled to the beneficial provision of the Double tax Avoidance Agreement (DTAA). Generally scope of the Royalty and FTS income as provided in Article 12 or 13 and is narrower in the DTAA due to various reasons some of these could be:

i. Narrower definition of Royalty

ii. Tax Rate may be more favorable

iii. Absence of the article on Royalty or FTS or both. Due to such absence of the Article, income may be treated as either Business Income being residual article under the Tax Treaty as it is in the nature of the business Income of the Non Resident when such article is absent or revenue may treat it as Income from Royalty or FTS under the Income tax Act, 1961.

iv. Most Favoured Nation clause whereby if favourable treatment is given to any other subsequent tax treaty same will be available to the DTAA under consideration.

v. Treaty with a clause of make available technical knowledge reduces the scope of the meaning of Royalty and FTS

Article 12 and 13 applies to the Non Resident while comparing it with the provisions of the Sec 9(1)(vi) and (vii) of the ITA however if a tax payer has business presence in India in the form of a fixed place permanent establishment, a service permanent establishment, dependent agent permanence establishment, etc. then Sec 44 DA of ITA applies and if beneficial then Income may be taxed as per Article 5 of DTAA and taxability of the tax payer would be governed by computational rule of Article 7 relating to Business Profits provided the right or property towards which the royalty is paid is effectively connected with such permanent establishment.

<u>Concessional Tax rate Is provided for Non Resident where payer of Service is Indian Concern as provided under Sec 115A of the ITA , however rate of tax deduction could be higher if Sec 206 AA is applicable or where Tax is borne by the Resident Payer for grossing up as required u/s 195A. There may not be any Tax deduction if Income is not chargeable to tax under the DTAA. If Tax is deducted in accordance with the above mentioned provisions then Non Resident is not required to file their Tax Return in India</u>

2. <u>Meaning of Royalty & Fees for Technical Service</u>

In order to understand the taxation provisions, one must first familiarize themselves with the meaning/definition as to what will be construed as Royalty Income and Fees for Technical Services

2.1 <u>Meaning of Royalty</u>

Royalty is generally a consideration received by a person – a creator or an innovator for allowing his work of art or scientific invention to be used commercially. Royalty is generally a payment received by the owner of an intangible right or knowhow under license in any technology transfer.

As per Explanation 2 of Section 9(1)(vi) For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill.

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in <u>section 44BB</u> (presumptive taxation of a non-resident, engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils)

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting **[**, but not including consideration for the sale, distribution or exhibition of cinematographic films**]** ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

2.2 <u>Analysis of Section 9(1)(vi)</u>

It may be noted that

a. That the clause(i) starts with word “Transfer of all or any rights”whereas clause(iii)starts with the words “Use of” with almost same phrase subsequent to these words
b. Subclause (ii)and(iv) both commences with the word imparting of any……
c. Sub clause (iva) starts with the “use” and “right to use” both together unlike the words only Use at subclause (iii)
d. The sub clause (v) starts with the Transfer of all or any rights in respect of any …..
e. The subclause (vi) do not deal with any rights, information and Property but deals with only services

   In the context of clause(i) and(iii) it may be pertinently noted that there cannot be use of the stated property unless right to use are transferred.

   In view of the fact that “use” cannot precede unless rights are transferred in respect of use of such property, mere use incidental to any service contract without transfer of rights will be outside the scope of the inclusion within the meaning of clause (iii) or (i).

2.2.1 **Meaning of the transfer of the rights in a Property or a sale**:

An appropriation takes place where the goods are situated at the time of the appropriation, not where the contract of sale is made, or where one party assents to an appropriation by the other. An authority given by one party to the other to appropriate the goods is an implied assent by the party giving the authority to a subsequent appropriation by the other, provided the appropriation is made in accordance with the contract..

In the context of the Sale of Goods Act, It may be noted that levy of tax is on transfer of right to use any goods. The tax is not on the actual use of the goods; the hirer may use the goods during the period specified in the contract in exercise of the right acquired thereunder or he may not use them at all.

2.2.2. **Lease of Equipment**:

If there is no possession or the control of the property with the payer, there may not be any user’s right with the payer but use may be by the service Provider himself for the provision of the service to the payer. Right to use or the Use of Process V/s use of the Transponder V/s the use of the transponder by the service provider himself, is very well distinguished in the Asia Sat’s decision.

Transfer of all or any rights contemplated in clause (i)and(v) are mutually exclusive rights available from those assets as referred therein only and rights of a particular property covered by a clause is specific and not intended to be covered more than one clause.

In any case of the matter, each clause is employed to target the specific character of income and one cannot try and fit the by pick and choose method ie if it is in the nature dealt with by a particular clause it cannot be fitted in any other clause unless context so infer.

2.2.3. **Imparting of the information**

Knowledge and experience is required to be Secret and one which is confidential, any information available in public domain or available to all at a price is not covered here but one which is of the payer and not of the other parties are the essential of the information in respect of the knowledge or the experience. In respect of the equipment, it has to be purely hire of the equipment but not the service where service provider employs the equipment. Sub clause (iva)dealing with the equipment lease excludes in it's scope the consideration received for services or hire in connection with the exploration Contract referred to in Sec 44BB.
It is difficult for Non Resident to offer income on net basis as majority of the expenses are incurred outside India and hence tax rate is fixed after considering the estimated expenses. It will be interesting to note here that Sec 44BB exclusion is not for the purpose of exempting such income but to allow the Non Resident Payer to pay taxes on a net basis unlike it is on a Gross basis under Sec 9(1)(vi).

2.2.4 **Copy Rights/Literary work**

Copy right /Computer software is also not defined in the I.T. Act although provided as explanation 4 inserted with retrospective effect from 1.4.1976, clarificatory in nature to Section 9(1)(vi) and not in the definition of Royalty and therefore meaning may be imported from the Copy right Act, 1957 may be for the purposes of the Act and certainly required for the purposes of the treaty ,see Gracemac Corporation v/s ADIT [2010] 42 SOT 550 (Delhi).
Generally license of the property with artistic or literary work refers to the manner and arrangement in which the work is embedded as IPR. These rights are generally not available to acquirer either under the license or the sale arrangement because License is subject to retention of the copy right ownership and sale is of Copyrighted article without affecting/parting with the copy rights.

2.3 Illustration to explain the above definition

Income generated in the nature of Royalty Income	Under Sub Clause	Explanation
Illustration 1: XYZ Scientific Pte. Ltd (XYZ) (A Singapore company)has formulated a vaccine for covid19. Patent lies with XYZ. How will the Income generated be treated		
With respect to patent, invention, model, design, secret formula or process or trade mark or similar property means		
XYZ has transferred the License of their patented vaccine to Berum India for exclusive rights to manufacture and sell the vaccine in Africa under the name of XYZ	(i)	Transferring of all or any rights (including granting of license) of Patent
Berum India manufactures vaccines in India, in order to register their vaccine in the name of XYZ , XYZ assisted them by imparting requisite information and data tested on human being on the working of the Vaccine	(ii)	Imparting any information concerning their work or use

If XYZ has transferred the right to License the patent to manufacture the vaccine and distribute the vaccine in Africa. Berum India pays royalty on sale of vaccines sold in Africa or will not require additional licence to use the Patent as right to transfer the License will include the right to use but such right to use Patent cannot be for any other territory	(iii)	Actual Use of Licenses Patent for registering the Vaccine
With respect to technical, industrial, commercial or scientific knowledge, experience or skill		
Berum India is relatively new in the vaccination market. It regularly consults XYZ for gaining information pertaining to the technique of producing the vaccine with various manufacturing parameters the expiry parameters of the vaccine The obstacles faced by XYZ in their manufacturing process experience. XYZ would charge a fees for imparting any information to Berum India in respect of the Licensed Patent .	(iv)	Imparting of any Information which are confidential to them other than what is available in the public Domain
With respect to any industrial, commercial or scientific equipment		
<u>Illustration 2:</u> Hydro Maritime FZE, a company in UAE, dry leases out its Vessels (Ships) to India Maritime LLP for its cargo business in and around India. India Maritime pays a lease rental to Hydro Maritime for lease of the vessel. Such lease rental is in the nature of Royalty (read with clause 2.6(v))	(iva)	Use or Right to Use…Equipment
With respect to any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting		
<u>Illustration 3:</u> R&B a music composer in Netherlands is a famous music composer known globally, all his music is copyrighted. Mr Shyam Varma, an Indian director has requested R&B to use one of his compositions in an upcoming movie. R&B has agreed to let Mr Shyam use his composition with or without modification but at a certain fee. Such fee paid will be in the nature of Royalty	(v)	Transfer of all or any rights in respect of use(no license to right to use) of literary or the Artistic Work.

2.4 <u>Broadly, the following conditions need to be satisfied for a payment to be characterized as "royalty" –</u>

(i) The amount must not be in the nature of capital gains;

(ii) The recipient of the Royalty must be the owner/licence holder of the underlying asset in connection with which the royalty is received;

(iii) The transaction must not be that on an outright sale basis

2.5 <u>Royalty income is deemed to accrue or arise in India if payable by</u>

(i) the Government ; or

(ii) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(iii) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India

If Resident Payer has a Business outside India or any source of Income outside India , if Royalty is paid in respect of such a business then it is not chargeable to tax in the hands of the recipient of such an Income , question of it's chargeability in the hands of Non Resident for his business outside India does not arise.

2.5.1 **Specific and General Provisions**
The structure and historical development of it's evolution of Sec 9 also suggest that Sec 9(1)(1) is general in nature while other Sec from Sec 9(1)(ii) to 9(1)(vii) is of a specific nature and hence while examining the nature of Income Specific provision will take priority over the general. This was held in decision **Commissioner Of Income-Tax vs Copes Vulcan Inc. on 25 February, 1985,1987 167 ITR 884 Mad and followed in subsequent decisions.**

2.6 Retrospective Amendment brought in by FA 2012

2.6.1. **Explanation 4**.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

2.6.2. The explanation applies to Sec 9(1)(vi) and not specifically to clause dealing with Copy rights. Hence, the computer software has been recognized as a separate item not only in 2nd proviso to clause (vi) but in Explanation 4 also and has been included in the definition and within the scope of the words 'right', 'property' or 'information'. The same has not been included in the meaning and scope of the term copy rights or the 'literary work' under clause (v) to Explanation 2 dealing with copy rights , scientific, artistic and the literary work. The license agreements found in case of software are thus the conditions of the sale of the product, a work a keen to a copy righted article and may not be termed as a grant of license to use the product.

2.6.3. **Implications of Explanation 4**

The main reason for inserting Explanation 4 was to put the long standing dispute of whether by making payment for software, the licensee gets rights in the "copyright" of the software and can the same be taxed as royalty, by inserting payment for software in the definition of royalty the lawmakers have intended to clarify the dispute. However considering the fact that a non-resident assessee can opt to be governed by the Act or the DTAA whichever is beneficial, the dispute still continues and in most cases recourse to Article 3(2) of the treaty to find a meaning of the word or the phrases will lead to the

meaning under the Copyright Act,1957, for the purposes of the treaty because Copy right is not defined under the Income Tax Act within the definition of the Royalty.
As per the provisions of section 2(o) of the Indian Copyright Act, 1957 the term 'literary work' includes computer programs, tables and compilations including computer data base. Therefore, the computer software has been recognized as a copyright work in India, if they are original intellectual creations.
“Computer programme" as defined in the Copyright Act, means a set of instructions expressed in words, codes, schemes or in any other form, including a machine-readable medium capable of causing a computer to perform a particular task or to achieve a particular result. The words 'schemes or in any other form' would seem to indicate that the source code and object code of a computer programme are entitled to copyright protection. It may be noted here that copyright protects the expression of an idea and not the idea itself. The ideas embedded in the software are therefore not protected but the ways by which the ideas are expressed in the source code are protected. These license agreements in case of software are thus the conditions of the sale of the product License and cannot be termed as a grant of license to use the product as whatever is transferred is forever.
The above dispute has finally been put to rest by the landmark judgment of the honorable Supreme Court, which said that payments made to non-resident for import of software is not a royalty (explained in detail below in clause 3.1)

2.7 <u>Explanation 5 of Section 9(1)(vii)</u>

Royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(i) the possession or control of such right, property or information is with the payer
(ii) such right, property or information is used directly by the payer
(iii) the location of such right, property or information is in India.
This is introduced mainly to target the dry lease or wet lease of the Equipment when the equipment is not in the control of the payer of the service/property hire

2.7 .1 **Implications of Explanation 5**

Explanation 5 seeks to clarify that once a right, property or information is deemed to be covered under Explanation 2, the interpretation would continue to remain so irrespective of possession or control of the right, property or information, direct or indirect use of the right, property or information or location of the right, property or information. However the retrospective changes brought in by FA 2012 cannot supersede the provisions of DTAA. The internationally accepted and judicially recognized requirement that use’ involve control / possession of or physical access to the Industrial, Commercial or Scientific equipment should vest with the user cannot be overridden by the domestic laws

2.8 <u>Explanation 6</u>

For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret

2.8.1 **Implications of Explanation 6**

While the above Explanation does away with the requirement of the process being secret, [(as referred in 9(1)(vi)(i)] it may be relevant to consider the decision of the Calcutta High Court in MV Philips v. CIT [1988] 172 ITR 521 which held that, once specialized knowledge becomes public; the person loses the exclusivity in respect of such special knowledge and hence, loses the right to receive any royalty in respect of the same. Thus, for a payment to be classified as royalty, 'exclusivity' of the subject matter is of crucial relevance.

Revenue in Asia Sat contended that the issue to be decided was whether the customers were merely using a physical asset or were they using the process installed in the transponder.

It was argued by the Assessee and approved by the court that the term —process occurring in Clause (iii) of Explanation 2 to Section 9(1)(vi)means a process which is an item of intellectual property. The process employed in the transponder of a satellite, i.e., of changing the frequency and amplifying the signal is not at all an item of intellectual property because that process has been in the public domain for more than half a century. The payment received by AsiaSat from its customers is, therefore, the payment made by a Customer in a chafffeur driven Car as agreed and approved by the court.

3. Meaning of Royalty: Judgements

(i) Standard Services : In case of DDIT, Pune vs John Deere India (P) Ltd (2019) , ITAT Bench Pune held that receiving I.T. services from its associate entity outside India and making payment of IT support charges, i.e., internet charges, use of e-mail charges, back up support services, etc. was not in the realm of Royalty as there was no technology was made available to assessee by its foreign associate company.

The assessee company also received lease line services for transmitting data on payment of charges. It was held that since the assesse was only using the lease line for transmitting data and there was no lease of any equipment by foreign concern of assessee to it, lease line charges paid by assessee could not be considered as 'royalty' a normal business services not chargeable to tax in the absence of any business connection in India U/S 9(1)(i)

(ii) Service in respect of the Property: In case of Godaddy.com LLC v. ACIT [2018] (Delhi – Trib.), the asssessee company was engaged as accredited domain name registrar authorized by Internet Corporation for Assigned Names and Numbers. The assessee had income from domain registration fees which was claimed to be not taxable in India. Apex Court in the case of Satyam Infoway Ltd. v. Siffynet Solutions (P.) Ltd. AIR 2004 SC 3540. In the instant case, the Supreme Court held that the domain name is a valuable commercial right and has all the characteristics of a trademark and, accordingly, domain names are subject to legal norms applicable to trademarks. Thus, the rendering of services for domain registration was equivalent to rendering of services in connection with the use of an intangible property which was similar to trademark.

Refer Sec 9(1) (V) Explantion 2, clause VI, Rendering of services in connection with the activities referred to at I to iv ……….

(iii) Information and Experience :In case of DIT v. Haldor Topsoe [2014] (369 ITR 453) (Bombay HC) it was held that that every case imparting of any information concerning technical, commercial, industrial or scientific knowledge, expertise of skill by itself has not been brought into the definition of royalty. For instance, in a contract for supply of equipment, giving information so as to guide the buyer to install the equipment at site and thereafter to use it would not be royalty.

(iv) Scientific Equipments/Hoisting Services : In case of DDIT vs Savvis Communication Corporation (2016), The Mumbai Tribunal held that payment received for providing web hosting services though involving use of scientific equipment cannot be treated as consideration for use or right to use of scientific equipment, which is sine qua non for taxability under section 9(1)(vi) read with Explanation 2 (iva). Similar view was taken by ITAT Mumbai in case of ITO vs. People Interactive (I) P Ltd wherein Shaadi.com's payment for web hosting charges paid to Rackspace US by shaadi.com is not royalty u/s 9(vi). The ITAT held that no physical access or right to operate equipment situated outside India was given to assessee and payment is not for use of equipment but for hosting services

(v) Dry Lease :The I-T Appellate Tribunal in the case of West Asia Maritime Ltd vs ITO (111 ITD 155) and Poompuhar Shipping Corp. Ltd vs ITO (109 ITD 226) has held that ships are equipment. So lease rentals paid by a resident to a non-resident should be subject to tax in India, but tax treaties with countries such as Sweden, Israel, the Netherlands, Greece and Belgium do not consider payments for the use of or right to use ICS equipment as royalties. Further, the treaty executed with Ireland excludes aircraft from the definition of royalties. Accordingly, in case of such treaties, payments for the use of or right to ICS equipment should not be considered as royalties.

3.1 <u>Import of software is not a Royalty:</u>

(i) The Supreme Court recently on March 2nd, 2021 ruled that payments made to non-residents for software purchase can't be taxed as royalty, setting at rest a long-standing row. Settling the 20-year dispute, a Bench led by Justice RF Nariman said "…the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through the End-User Licence Agreements/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons (resident Indian importers) referred to in Section 195 of the Income Tax Act were not liable to deduct any TDS under Section 195 of the Income Tax Act." In all there situation there was no transfer of right in the copy right of the software as it either always belonged to Non Resident, as License to the end user has always been the sale and a transaction of the whole sale with the distributor.

(ii) A potential repercussion of the judgement that may require further consideration by affected businesses is the effect on liability for the equalisation levy (EQL). As from 1 April 2020, the scope of India's EQL was extended to introduce a 2% levy on consideration received or receivable by a nonresident "e-commerce operator" from an "e-commerce supply of goods or services" in India. A proposed amendment to the levy in the 2021/22 union budget provides that only those payments not otherwise taxable as royalties or fees for technical services would be subject to the EQL. Since software license fees no longer are taxable as royalties following the Supreme Court's decision, it must be examined whether the fees would be subject to the 2% EQL.

4. Difference between Royalty and FTS

Basic differences between royalty and FTS is summarized below:

(i) In FTS, the supplier undertakes and guarantees result whereas Royalty is basically for letting of IPRs or for imparting some exclusive information and knowledge. Consideration for services connected with commercial licensing of rights and knowhow are also in the nature of Royalty.

(ii) The consideration for the services not connected with royalty may fall in the category of Fees for Technical Services (FTS).

(iii) Generally, in the case of Royalty, the owner enables the user to use the technology. In FTS, the owner uses his technology to perform some service for a consideration excluding the standard Services where there is no transfer of knowledge or skill.

(iv) Royalty is usually paid for some innovation or creation, whereas FTS is paid for providing specialized services

5. Meaning of Fees for Technical Services

As per Explanation 2 of Section 9(1)(vii) fees for technical services" means any consideration (including any lump sum consideration) for the **rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)** but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries"

The meaning of managerial, technical or consultancy is not defined under the ITA and hence ordinary meaning will have to be employed to understand the nature of the services as there could be number of services outside the scope of the section i.e., neither consultancy, nor managerial, nor technical as per GVK Industries Ltd. [2015] 371 ITR 453 (SC)).

i. The expression "consultancy" involves giving of an advice/opinion/ recommendation or counseling or advisory services by a professional. Expertise in a technology is not essential while providing consultancy services. However, an element of expertise or special knowledge on part of the advisor is essential. Advisory service which merely involves discussion and advice of a routine nature cannot be classified as consultancy services. Refer - Intertek Testing Services India (P) Ltd. [2008] 307 ITR418 (AAR)).

ii. The ordinary meaning of the term "technical" involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. The word technical is involving or concerning applied and industrial sciences. Consultancy is generally understood to mean advisory services. Further, it may be fair to state that not all kind of advisory could qualify as technical. services. For any consultancy to be treated as technical services, it would be necessary that a technical element is involved in such advisory. Thus, the consultancy should be rendered by someone who has special skills and expertise in rendering such advisory. (Skycell Communication Ltd. vs DCIT [2001] 251 ITR 53). The term 'technical services' takes within its sweep services which would require the expertise in technology or special skill or knowledge relating to the field of technology. As per the concise oxford dictionary, the term 'technical services' means belonging or relating to art, science, profession or occupation involving mechanical arts and applied sciences. Refer Le Passage to India Tours & Travel (P) Ltd. [2014] 369 ITR 109 to distinguish technical service from consultancy services.

Thus these phrases are overlapping in nature and one can consider their ordinary meaning to distinguish one from another. Further, managerial service is also in the nature of consulting services but it may be easier to distinguish managerial services from other two as it is in the nature of management, administrative, supervisory etc.

iii. The expression "managerial" service needs to be considered in a commercial parlance. It has been interpreted as follows:
It signifies service for management of affairs or services rendered in performing management functions. It involves controlling, directing or administering the business. It means managing the affairs by laying down certain policies, standards and procedures and then evaluating the actual performance in light of the procedures so laid down. A "managerial" service has a definite human element attached to it or an application of human mind or can only be rendered with human interface/human intervention. It will be interesting to witness as to how Artificial Intelligence development (AI Services) will modify these general principles and the understanding.

6. Nature of Services - Judicial Precedents

(i) Consultancy Services - In case of GVK Industries Ltd. [2015] 371 ITR 453 (SC), the Honorable Supreme Court held that Financial Services provided by a non-resident is treated as consultancy services and taxable as FTS, since the non resident company providing the service has the skill acumen and knowledge in the specialized field to provide such services.

(ii) Technical Services - As per Delhi ITAT in Le Passage to India Tours & Travel (P) Ltd. [2014] 369 ITR 109, it is held that not all kinds of advisory qualify as technical services. Thus, the consultancy should be rendered by someone who has special skills and expertise in rendering such advisory which is in the nature of pure and/or applied science

(iii) Standardised Facility :The Madras High Court in the case of Skycell Communication Ltd. Vs. DCIT (2001) 251 ITR 53 (Mad) had examined the scope of term technical services and held that installation and operation of sophisticated equipment with a view to earn income by allowing customers to avail of the benefits of the user of such equipments does not result in the provision for technical service to the customer for a fees .

(iv) Intermediary Services: In case of Digi Drives (P.) Ltd vs. ACIT (2021),. ITAT Delhi gave a ruling in favour of the assesse, stating that mere rendering of service of procurement of export orders by a non-resident company for Indian company does not fall in category of managerial/consultancy services as explained in Explanation 2 to section 9(1)(vii).

(v) Grading Services: In Diamond Services Intl. – Mumbai High Court held that Consideration for grading of diamond does not result in FTS as it cannot be said to have transferred its experience, knowledge or skills to the customer. Also, payment can be regarded as 'fee for technical included services' only if the twin test of rendering services and making available technical knowledge at the same time is satisfied [

7. Income of a non- resident will be deemed to accrue or arise in India under clause 9(1)(vi) and 9(1)(vii) whether or not the

(i) the non-resident has a residence or place of business or business connection in India; or
(ii) the non-resident has rendered services in India.

The clause (i) above was inserted in the Act post the decision of the Supreme court in Ishikawaji Harima case, however it has been held in subsequent decisions of various courts in Jindal Thermal Power Company Ltd. vs. DCIT [2009] (225 CTR 220) (Karnataka HC), Clifford Chance vs. DCIT [2008] (318 ITR 237) (Bombay HC), and M/s Bovis Lend Lease (India) Pvt Ltd vs. ITO [2009] (127 TTJ 25) (Bangalore ITAT), that this amendment brought in 2007 by way of explanation to Sec 9(2) is of no consequences and law laid down by the supreme court still holds good. The position was finally settled when law was again amended in 2010 by inserting (ii) above that FTS is chargeable to tax irrespective whether Non Resident has rendered the services in India or not.

8. Taxation of Royalty and FTS in India with PE.

Section 44 DA states that where royalty or fees for technical services are received by a non-resident from an Indian concern (a) in pursuance of an agreement made after 31.3.2003, (b) such non-resident carries on business in India through a PE in India, or performs professional services from a fixed place of profession in India, and (c) the right, property or contract in respect of which such income are paid is effectively connected with such PE or fixed place, then such income shall be computed under the head "Profits and gains of business or profession" and sections 28 to 44C of the act will be applicable and all the deductions provided in the Act will be available.

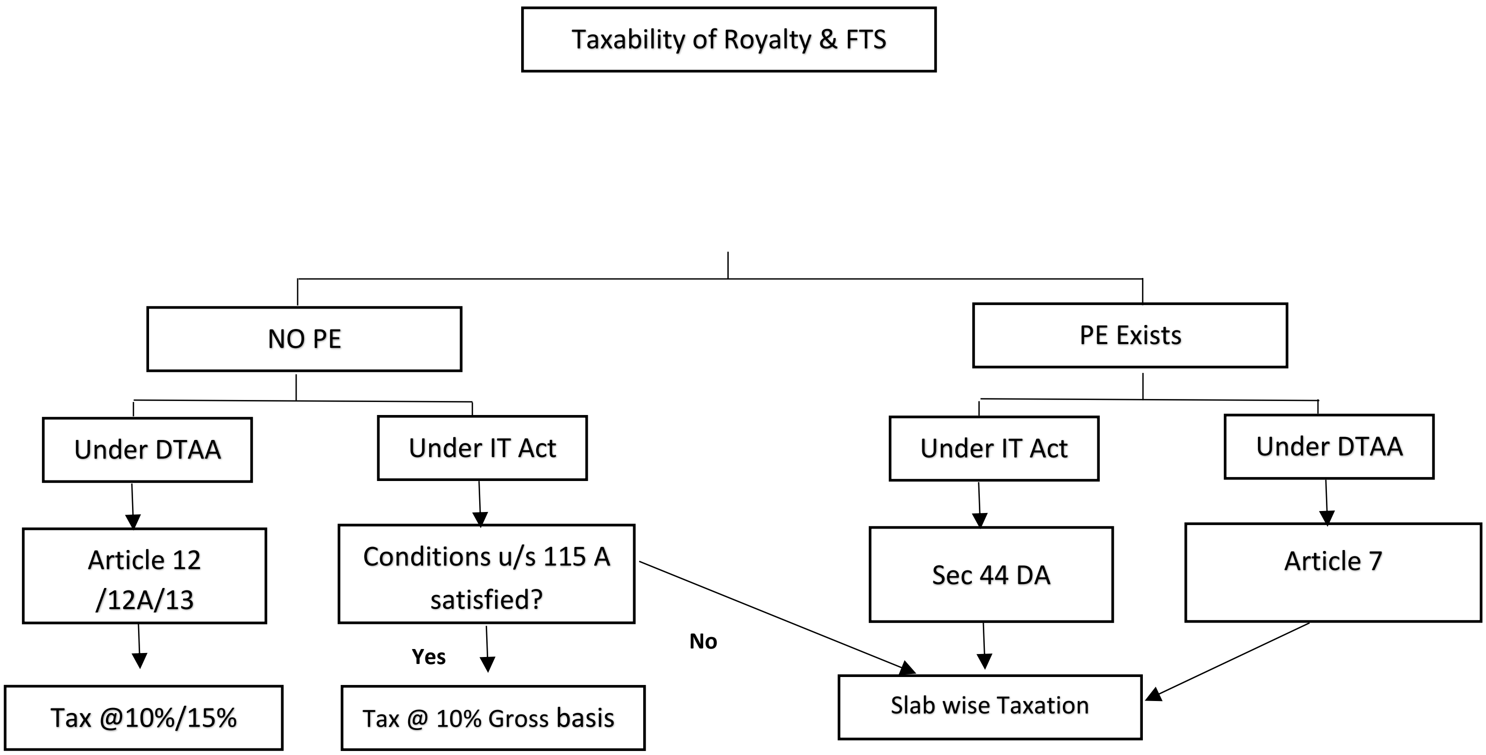
It may be noted that any services rendered by a Non Resident in accordance with the policy of the Government of India will qualify as the one pursuant to the agreement as refereed above even it is rendered after such date.

8.1 **Taxability Rates and Compliance:**

(i) As per section 115A, Income from Royalty and fees for technical services earned by a non-resident (not being a company) will be taxed at the rate of 10% (plus Surcharge and Cess)

(ii) No deduction under chapter VI-A is permitted If tax is deducted under section 115A

(iii) It shall not be necessary for an assessee to file his income tax return under section 139 if his income only comprises of incomes specified under Section 115A (which includes Income from Royalty and Fees for Technical Services), provided accurate TDS under section 195 has been deducted. Sec 115 A may apply to net basis of taxation



8.2 **Higher rate of Tax Deducted at Source**

As per Sec 206AA of the ITA in case a non-resident tax payer does not furnish his/her PAN Card to the person responsible for deducting TDS, the deductor will deduct TDS higher of the following rates:

a. at the rate specified in the relevant provision of this Act; or

b. at the rate or rates in force; or

c. at the rate of 20%.

Rule37BC (1) In the case of a non-resident, not being a company, or a foreign company (hereafter referred to as 'deductee') and not having permanent account number the provisions of section 206AA shall not apply in respect of payments in the nature of interest, royalty, fees for technical services , dividend and payments on transfer of any capital asset, if the deductee furnishes the details and the documents specified to the deductor such as TRC, Tax Identification number,address and the contact number and email id. Thus business income with PE or otherwise is not covered by the Rule.

9. Income Tax Act and DTAA

9.1 Definition of Royalty in DTAA.

(i) As per OECD Model

a. Article 12 (2) as per OECD Model – The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

b. Article 12(1) of OECD Model - Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

(ii) As per UN Model

a. Article 12 (3)of UN Model - The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

b. Article 12(1) & 12(2) of UN Model - Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Certain issues in connection with "Beneficial Owner" of the Royalty or the FTS has not been discussed here in the interest of the simplicity including certain others such as interpretation/ characterization of the Royalty or FTS as Business Income (when the article dealing with one of them or both is absent in the DTAA) , MFN clause, Net Basis of Taxation and the PE issues, payer is Resident of India or the Indian concern in the context of the turnkey project, Payment by Non Resident to another Non Resident on behalf of the Resident without claiming any reimbursement from Resident.

9.2 Definition of FTS – Article 12A of UN Model

The term "fees for technical services" as used in this Article means any payment in consideration or any service of a **managerial, technical or consultancy nature**, unless the payment is made :

a. to an employee of the person making the payment;

b. for teaching in an educational institution or for teaching by an educational institution; or

c. by an individual for services for the personal use of an individual.

9.3 Treaty provisions and Income Tax Act

(i) The definition of "royalty" under the OECD Model Convention is narrower when compared with the UN Model Convention. In view of the retrospective amendments made to section 9(1)(vi) by the Finance Act 2012 with regard to royalty, widening the scope thereof, the narrower definition as contained in the tax treaties could come to the rescue of the taxpayer.

(ii) The OECD Convention provide for taxation of royalty income in the state where person who beneficially owns the IPR is resident. In the UN Convention, the source (on income) state also has taxation rights, and the resident country may reserve its taxation right. Also, the tax is imposed by the source state at a pre-negotiated percentage of the gross amount. As per Section 9(1)(vi) and (vii) of Income Tax Act, Royalty/ FTS income is taxable in India if service is used/utilized in India. Place of rendering service not relevant. Since India is traditionally a net importer of technology and hence a payer of Royalty, it has followed the UN Model Convention in its negotiations with most of the countries

(iii) It is seen that the OECD convention does not have any clause on equipment royalty, which is available in the UN Convention. Rentals for commercial and scientific equipments fall under the category of equipment royalty

(iv) Fees for Included Services

India –US tax treaty incorporates a concept of Fees for Included Services (FIS). As per Paragraph 4 of Article 12 of India US tax treaty the definition of FIS is as under:

For purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or

(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

The term 'make available' means that the person acquiring the technical service is enabled to independently apply the technology. The word 'enable' is used in the sense that the technical services should be such that they make the recipient able or wiser in the subject matter, thus it reduces the scope of the FTS

For instance, a US resident (X) "makes available" technical knowledge, skill etc. to an Indian resident (Y), when X sends its experts to India to show Y's engineers how to produce an extra strong wall board, or when X modifies Y's formulas pertaining to oil refining process, to eliminate cholesterol in refined oil and trains Y's employees in applying these new formulas.

10. Conclusion

The subject has been the most controversial one and arguably, the largest number of court decisions are related to this topic. However one of the issues still unsettled is on employment services treated as FTS. Although the income from the fees for technical services is clearly distinguished from the purview of the employment income, it has become a most litigated subject, particularly when foreign company deputes technical personnel to provide consulting services to the Indian concern under the supervision of the Indian concern as an employer, while continuously remaining on the payroll of the foreign company. It has been always the attempt of the Revenue to tax it as Fees for Technical Services while Tax Payer would want to avoid the employee's presence as that of the foreign company and treat the payment made to foreign company as that of remuneration to the deputed technical personnel.