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The Coming of Age of International Tax Jurisprudence in India

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- Nishith Desai Associates

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The Coming of Age of International Tax Jurisprudence in India

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Juridical double taxation has been defined as "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods".[1] In times when economies are going global and borders fading, leading to liquid movement of goods, services and capital, double taxation is still one of the major obstacles to the development of inter-country economic relations.

Countries, recognizing the problems posed by double taxation, have, through the negotiation of bilateral treaties, tried to reduce the disincentive effect created by it, especially so as to encourage flow of capital into the country. The earliest known international bilateral agreement for the avoidance of double taxation was the France-Belgium treaty of 1843. However, international tax jurisprudence can perhaps be said to have begun in earnest with the efforts made by the Financial Committee on Double Taxation, set up by the League of Nations in 1921, which drafted the first model treaties for the avoidance of double taxation in 1928. Subsequently, the organization currently referred to as the Organization for Economic Cooperation and Development ("**OECD**") improved upon the work done by the League of Nations. In 1963 the OECD Model Treaty and commentaries were created.

It was recognized by the members of the OECD that "it is desirable to clarify, standardize and confirm the fiscal situation of taxpayers in each member country who are engaged in commercial, industrial, financial or any other activities in the other member countries through the application by all member countries of common solutions to identical cases of double taxation."[2] International tax jurisprudence has made leaping strides especially over the last few decades with globalization of the world economy, with an increase in adoption of model forms for bilateral treaties, commentaries by eminent jurists in the field of international taxation, such as Professor Klaus Vogel, Professor Philip Baker, and Professor Arvid Skaar etc. are beginning to be referred to internationally.

In the initial stages, India's contribution to these developments was very minimal. It was not and is not a member of the OECD, and did not participate in the United Nations Model Treaty discussions in spite of being a member of the United Nations. India has been invited to participate in a number of committees / task forces set up by the OECD even though it is not a member. However, Indian tax jurisprudence made all efforts to be in sync with the evolution of international tax jurisprudence, and frequently adopted the "common solutions" proposed by the OECD and others. In fact in tax litigation cases, the judiciary gives a great deal of importance to international jurisprudence on the subject and in most cases tries to adopt an internationally acceptable view.

With the ruling in the case of *CIT v Visakhapatnam Port Trust*[3]*,* the judiciary re-emphasized the importance of international tax jurisprudence while interpreting tax matters in Indian courts. The Andhra Pradesh High Court made the following observation on the OECD commentaries:

"In view of the standard OECD models which are being used in various countries, a new area of genuine 'international tax law' is now in the

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[1] Klaus Vogel, "Klaus Vogel on Double Taxation Conventions" 3rd ed (1997), pg 2, Kluwer Law International, London

[2] Ibid

[3] (1983) 144 ITR 146 (AP)

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process of developing. Any person interpreting a tax treaty must now consider decisions and rulings world wide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adaptation is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant."

Accordingly, with the growth in the economy and a requirement for an understanding of international taxation, reliance was placed by India on the developments already taking place all over the world, and these developments were adopted and tailored to Indian juridical needs. Therefore, over the last decade or so, with the blossoming of the Indian economy, it has been interesting to see a change in the status quo. Where earlier Indian jurisprudence was dependant on and faithful to the developments taking place internationally, the Indian judiciary now began to reinterpret or elucidate further on concepts of international taxation so as to set an example for the rest of the world.

This turnaround could perhaps be attributed to the opening up of the Indian economy in the early '90s, when exchange control restrictions on the flow of money were significantly eased out, and India began to welcome inflow of foreign goods, services and capital into the country. It also woke up to the fact that an efficient tax judiciary is a major factor in deciding the location of investments, and started thinking of ways to deliver quicker and better decisions in taxation disputes, so as to set potential investors at ease.

The setting up of the Authority for Advance Rulings ("**AAR**" or "**Authority**") could be said to be indicative of the growing consciousness in India, of the importance of an efficient system of taxation. While India has always had a specialized tribunal to deal with taxation matters known as the Income Tax Appellate Tribunal ("**ITAT**"), it also set up a separate body, the AAR to give advance rulings to foreigners. This was significant as it was introduced in the era immediately post liberalization, to give foreigners comfort as to the extent of their tax liability in India, prior to making investments.

The AAR is empowered to only those matters relating to non-residents and specific classes or category of residents as notified by the Central Government, so as to ensure the quickest possible decision. In the case of non-residents, the AAR provides in advance, a binding ruling on the issues that could arise in determining their tax liabilities. This ruling is binding on the tax authorities and the applicant for that transaction. Therefore, time consuming and expensive legal disputes can be avoided, giving potential investors a comfort level with regard to their tax liability. The Authority is empowered to determine any question of law or of fact as specified in the application made before it in respect of a transaction which has been undertaken or is proposed to be undertaken by a non-resident.

Further, under section 90 of the Income Tax Act, 1961 ("**ITA**") the Government of India has been empowered to, and has entered into various agreements with Governments of different countries for the avoidance of double taxation and for prevention of fiscal evasion ("**DTAA**" or "**Tax Treaty**"). These agreements did much to encourage flow of investments into India. One such agreement between India and Mauritius, for example, was so beneficial to foreign investors

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that it is estimated that around 43%[4] of the investment into India comes from Mauritius.

Clearly, India is developing its own expertise in the field of international tax jurisprudence and law, cleverly juggling the requirements of an increasingly globalized world with the fiscal interests of the country. India has managed to encourage trade relations and develop its system of taxation at the same time.

This article discusses a few landmark judgments which have led to the evolution of tax jurisprudence to determine the answer to this question. While it does not purport to provide an exhaustive summary of all Indian tax decisions, it aims to indicate the evolution of the Indian tax system and its increasing contribution to international tax jurisprudence, as seen by the decisions of Indian tax authorities and quasi-judicial bodies such as the Authority for Advance Rulings. These are beginning to contribute to the general development of tax jurisprudence the world over, when it requires guidance and direction, and courts in other countries, especially all over Asia, are beginning to take note of the development of Indian tax jurisprudence.

Tax evasion and tax avoidance

International tax planning depends heavily on prevalent definitions of tax evasion and tax avoidance.

India used to follow English common law and relied on the doctrine laid down by Lord Tomlin in *IRC v. Duke of Westminster*[5] which said that "*every man is entitled if he can, to organize his affairs so that the tax attracted under the appropriate acts is less than it otherwise would be*". However, it was perceived that the doctrine in Duke of Westminster was given a burial in *WT Ramsay Ltd v IRC*.[6] In which it was held that, where a transaction has pre-arranged artificial steps which serve no commercial purpose other than to save tax, the proper approach is to tax the effect of the transaction as a whole. Closer to home, the Indian Supreme Court[7], in the landmark ruling of *McDowell and Co Ltd v CTO*[8] also reiterated the Ramsay principle by departing from the Westminster principle, and endorsed, *on very specific facts* that in tax avoidance cases substance should be examined and form should not be accepted per se. However, the McDowell ruling was often used in later years to strike down genuine cases of tax planning. For over a decade, the McDowell ruling was resorted to by the revenue authorities, who more often than not, misapplied and abused the McDowell ruling to strike down cases of tax planning by holding them out to constitute a scheme for tax-avoidance.

Finally and most recently, in the landmark decision in the case of *Union of India (UOI) and Anr vs Azadi Bachao Andolan and Anr*[9] *("**Azadi Bachao Andolan**")* the Supreme Court held that the McDowell ruling cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement, which is perfectly permissible under law and has the effect of reducing the taxpayer's tax burden, must be

[4] As per a Report by Deutsche Bank Research (2004)
[5] IRC v. Duke of Westminster (1936) 19 TC 490
[6] (1982) AC 300
[7] It may be noted that India has only one Supreme Court, which serves as the apex court of the country
[8] 154 ITR 148 (SC)
[9] (2003) 263 ITR 706 (SC)

looked upon with disfavor. The Supreme Court observed that if a court finds that a person is free to act in a manner according to his requirements, his wishes in the manner of doing any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same fall in the category of colorable device or sham transaction, which may properly be called a device or a dubious method to evade taxes. Therefore, effectively, tax planning in itself would not be considered illegal.

The current position would be that, while Indian courts have upheld the taxpayer's right to save taxes by using legal framework, they have also come down harshly on dubious devices which aim only at tax evasion. This struggle is brought to the centre stage, in transactions, which are cross border, where the interactions of public and private international laws as well as the interaction of domestic and bilateral tax treaties become relevant. Azadi Bachao Andolan therefore, being a judgment that retracts from rigidity and recognizes the need for a tax system conducive to investment, has been a judgment noted for its detailed analytical discussion on tax avoidance and tax evasion.

Applicability of treaty benefits

One of the issues that have come up repeatedly has been with regard to the applicability of Tax Treaty benefits to parties, and whether it is required that parties *pay tax* in both the relevant countries, to be able to avail the benefit provided by a DTAA. This issue has been examined time and again, significantly in the cases of *General Electric Pension Trust*[10] and in the context of applicability of the India-UAE Treaty, as only banking and oil companies are taxed in UAE while other categories of taxpayers, (resident firms, companies, and individuals) are not; these are discussed below.

In the case of General Electric Pension Trust, the applicability of the India-US DTAA was looked at in the context of Article 4 of the DTAA which discusses the residency status of trusts. As per this article, the residency of a trust would be established by the location of the beneficiaries. The AAR held that the applicant being tax exempt in the USA could be treated as a tax resident of the USA for the purpose of the Treaty only to the extent that the income derived by the applicant is *subject* to tax in the USA as the income of a resident either in its hands or in the hands of beneficiaries to avail of the terms of the Treaty.

The applicability of international tax treaty benefits was also discussed in a series of cases, in the context of the India-UAE DTAA. In the first case of *MA Rafik*[11] the AAR held that although individuals are not required to *pay tax* in the UAE, they are *liable to tax* and may be asked to pay income tax in the future. In ascertaining whether one is a resident for the purposes of the Treaty, it is necessary to also take into consideration future tax liability. Further, it was stated that the Indian Government was aware of the lack of tax on individuals in the UAE at the time of entering into the treaty, and this must be kept in mind while determining Treaty applicability. However, it may be noted that the AAR in a separate ruling in the case of *Cyril Eugene Pereira*[12] stated that the applicability of treaty would be determined by present and not future tax liability, which is why individuals, who were not liable to tax in the UAE,

[10] 280 ITR 425

[11] 213 ITR 317
[12] 239 ITR 650

could not avail of Treaty benefits. This was reiterated by the AAR in the case of *Abdul Razaq Menon*[13] which cited and agreed with the AAR ruling in the case of Cyril Eugene Pereira.

Most recently, in the case of *Green Emirates Shipping and Travels*[14] a shipping line based in the UAE had profits from shipping operations and claimed the benefit of the India UAE DTAA. The tax authorities relied on the cases discussed above to hold that, as the assessee was not paying tax in the UAE, it would not be eligible to treaty benefits. However, the Mumbai ITAT, looking into a number of cases as well as commentaries by Professor Klaus Vogel, to hold that a tax treaty not only prevents current but also 'potential' double taxation. "Therefore, irrespective of whether or not the UAE actually levies taxes on non-corporate entities, once the right to tax UAE residents in specified circumstances vests only with the Government of UAE, that right, whether exercised or not, continues to remain exclusive right of the Government of UAE." The treaty benefits were therefore held to be applicable to the shipping line.

Further, this principle of applicability of treaty benefits where the assessee has a tax residency certificate was reiterated by the apex court in the case of *Azadi Bachao Andolan,* where the apex court reiterated that the benefit of a DTAA would be available where a certificate of residency was provided. In this particular case it upheld the validity of Circular 789 issued by the CBDT clarifying that wherever the Mauritius revenue authorities have issued a certificate of tax residence, such certificate will constitute sufficient evidence for accepting the status of Mauritius tax residents for applying the provisions of the India-Mauritius tax treaty.

As has been discussed, AAR rulings are only binding on the parties involved, though they may have persuasive value in third party cases. Therefore, the current position as per the ruling of the ITAT in *Green Emirates Shipping and Travels* and the apex court ruling in the case of *Azadi Bachao Andolan,* is that the DTAA will apply irrespective of whether there is actual liability to tax in the other country, if residence in that other country can be established.

Interpretation of DTAA

In *Deputy Commissioner of Income Tax* vs. *ITC*[15] it was held that interpretation of a DTAA must be in consonance with the principles of international law. Therefore, while reading a Treaty one must take into consideration the protocol and also the manner in which other DTAAs are worded and interpreted.

The following is also a discussion of some specific areas of taxation where there have been landmark judgments of international relevance.

Permanent Establishment

Parallel to the PE theory, there exists a concept known as business connection in India, as per which a foreign entity was taxable in India if it had a business connection in India. Where India does not have a DTAA with a country, the rule of business connection would apply.

The term 'business connection' has a wider scope than PE. However, the general concept is

[13] 276 ITR 306
[14] (2006) 99 TTJ 988 (Mum)
[15] ITA Nos. 970, 971 and 973/Cal/1998

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that there should be sufficient territorial connection or nexus between the earning of income by a non-resident outside a country and activities in the country seeking to tax him. A business connection in this context would involve a relation between a business carried on by a non-resident, and some activity in India which contributes directly or indirectly to the earning of the profits and gains of that non-resident. Thus, a business connection would include a branch, a factory, an agent, or even the seat of management of the non-resident in India. Further, where business connection is said to exist, the income of the non-resident which is taxable in India would be that, which is attributable to the operations carried out in India.

The definition of PE is provided in Article 5 of the DTAA. PEs can be of various kinds; they can be a fixed place of business PEs, agency PEs or service PEs. The service PE concept is unique to India and some other countries, and is not contained in the OECD Model Treaty. Indian judgments have examined the definition of PE under various circumstances, for example the constitution of a fixed place PE in the case of activities taking place on the continental shelf, installation activities etc, the requirements for a fixed place PE, what constitutes a service PE amongst others.

Whether the income from investments made by foreign institutional investors and others in India constitutes business income or capital gains has been a point of much discussion over the last few years with judicial opinion divided. The AAR initially tended to hold that the income from investments would constitute capital gains and not business income, and would be taxable in India along with other kinds of income. However the question was set to rest in the case of *Fidelity Advisors Series VIII*[16] where the AAR ruled that the income of foreign institutional investors in India from investments is business income and not income from capital gains. Certain criteria were laid down to determine whether the income was business income, some of them being that the investments should be a regular and periodic activity, and where a company purchases and sells shares it must be shown that they were held as stock in trade. The charter documents of the company should give the company the power to purchase and sell securities. It was also held that there should be an established regulated system of making the investments. Further, if the purchase and sale of shares is with the motive of earning profit, then the activity carried on by the foreign institutional investors would be in the nature of business.

[17] F.No.149

In this regard, the Central Board of Direct Taxes ('CBDT')[17] has issued a draft circular[18] laying down certain tests to distinguish between shares held as stock-in-trade and shares held as investment.

Further, in cases such as *XYZ/ABC Equity Fund v. CIT*[19] the AAR held that collective investment vehicle like private equity funds which have set up business in Mauritius and made investments in Indian companies will be entitled to Treaty benefits.

Discussion on PE in the context of captive business process outsourcing units

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[16] 271 ITR 1
[17] 287/2005-TPL
[18] It may be noted that the circular is a draft circular and not part of the law as yet
[19] (2001) 116 Taxman 719

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One of the daunting questions which the outsourcing industry has been confronted with is whether outsourcing to Indian companies, particularly to captive service providers/ manufacturers would cause a PE to come into existence. During the last decade or so, India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT enabled entities in India. Such entities are usually incorporated as subsidiaries of the foreign enterprise or in a few cases may even be an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provisions of services and answering sales related queries, to the provision of actual services such as software maintenance service, debt collection service, software development service etc.

The CBDT issued a Circular[20] on taxation of IT-enabled Business Process Outsourcing Units in India, wherein it indicated that if the Indian BPO was paid an arm's length price for its services, there would be no further attribution of profits to the PE in India. In fact, the principle laid down in this Circular happens to be in line with international thinking, and reference may be drawn to the OECD's draft discussion paper on attribution of profits to a PE wherein the OECD has indicated that attribution of profits to a PE based on arm's length principle would be an appropriate approach.

In this context, the AAR pronounced a landmark judgment in the case of *In Re Morgan Stanley &Co.*[21]. Morgan Stanley & Co, a U.S. investment bank ('Morgan Stanley') is in the business of providing financial advisory services, corporate lending and securities underwriting services. Like many other multinationals, Morgan Stanley outsources a wide range of high-end support services to its captive group company, Morgan Stanley Advantage Services Private Limited ('MSAS'). An important dictum of the AAR was that even where a PE was found to exist, if it was remunerated on an arms length basis, the degree of profits attributable to the PE would be restricted to those it was remunerated for. This was a ruling of great relevance, as even today, attribution of profits to a PE is a matter of much debate and discussion, and there is no international consensus on this issue.

The AAR in the above case held that the captive service provider *i.e.,* MSAS is not a fixed place of business PE of Morgan Stanley, as it is not the business of Morgan Stanley that is carried out from there but the business of MSAS. The Authority also held that MSAS would not constitute an agency PE of Morgan Stanley, one of the factors for this being that it does not have the authority to conclude contracts on behalf of Morgan Stanley.

Importantly, on an equally sensitive issue of whether a PE was constituted, a portion of global profits of Morgan Stanley would be taxed in India where the Indian company was compensated at arm's length. Given that multinationals doing business with an associated company in India are required to comply with transfer pricing and to compensate the Indian entity at arm's length, this finding provides much needed certainty regarding exposure to tax in India.

[20] Circular No. 5/2004, dated 28-9-2004
[21] (2005) 272 ITR 416 (AAR) The income tax department has appealed against this ruling at Supreme Court level by filing a special leave petition. The matter is *sub-judice*

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In India, an advance ruling is binding only on the Applicant. It has significant persuasive value and plays a critical role in the evolution of international tax jurisprudence. Therefore, the outsourcing industry in India was resting easy in the knowledge that outsourcing in itself does not expose the business income of multinationals to corporate tax in India. However, the tax department has recently filed an appeal in the Supreme Court by way of a Special Leave Petition and it is only after the apex court passes judgment that the issue will be resolved.

The question of attribution of profits which is an evolving area in international taxation has also been discussed in the context of fixed place of business PE. So in determining the profits attributable to an IT enabled BPO unit constituting a Permanent Establishment to the Head Office or by the Head Office to the Permanent Establishment is on the basis of 'arm's length principle'. The AAR in *Brown and Root Inc.*[22] and *Norasia Container Lines*[23] discussed the definition of PE in the context of offshore pipelines and ships. In this case the Ruling of AAR was that activity of installation of the pipeline cannot be considered to constitute PE, especially since the activity is less than 120 days. The element of permanence in relation to an establishment, if any, would be attracted under Article 5(2)(k) only if the installation project continues for a period of more than 120 days and that condition is not satisfied here.

Service PE

Similarly, India has also evolved jurisprudence relating to "service PE" which is a concept unique to India and some other countries. The service PE concept is included in Article 5(2)(l) of Indian DTAAs, which states that where there is provision of services by an enterprise within a contracting state through employees or other personnel, a service PE of the enterprise can be said to exist. With regard to the exposure to service PE upon the proposed deputation of personnel, in the case of *Morgan Stanley*[24] the Authority has held that the presence of employees for over 90 days would constitute a service PE in India. The Authority has rejected the contention that as the deputed personnel are sent to MSAS to oversee the functioning of MSAS and to perform quality control and risk management services, they cannot be said to be the employees of the Applicant even though their salaries were borne by the Applicant.

Royalties and Fees for Technical Services

The tax treatment of royalties and fees for technical services ("**FTS**") in India would depend on the definition of royalty and FTS contained in the relevant tax treaty which is being applied. In case this definition is more beneficial to the non-resident taxpayer as compared to the definition contained in the Indian domestic law, he would be entitled to choose this definition over the definition provided for in the ITA.

Although there is a broad definition of fees for technical services under the ITA, this definition is not as specific as most DTAAs. Therefore, it has been a matter of discussion, what fees for technical services will comprise of. The Madras High Court, in its landmark decision in case of *Skycell Communications Limited & another v. DCIT & others*[25] discussed the issue in detail, to hold that "*The popular meaning associated with*

[22] 237 ITR 156
[23] 267 ITR 722

[24] *Supra note 22*
[25] *(2001) 251 ITR 53 (Mad)*

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'technical' is involving or concerning applied and industrial science", and clarified that *"mere collection of fees for standard facility provided to all those willing to pay for it does not amount to fees for technical services"***.**

One of the main contentious issues which the Indian tax jurisprudence has been faced with and which has always been a question over the last few years has been with regard to the characterization of income from sale of software or use of services in relation to the same.

In this regard, it may be noted that in pursuance of the DTAA being referred to, in case the income from software sales is treated as a sale of goods, or in other words, as business profits, no tax is levied in India, unless the selling foreign entity has a PE in India.

The characterization of income from software would also depend on the facts of the case and the rights associated with the grant or sale of the software.

In *Advance Ruling P.No. 30 of 1999*[26]*,* the AAR examined the taxability of income of foreign companies engaged in the operation of credit cards and travelers' checks. The AAR held that the payment made by an Indian company for accessing the foreign company's computer system and database was in the nature of royalty income and therefore taxable in India. However, in this case, the AAR did not seem to have appreciated the fact that the payment was being made for the use of services and for the use of intellectual property embedded in the software.

The nature of transaction when a right given in intellectual property was only incidental to the primary transaction was examined by the Madras High Court in *Commissioner of Income Tax v. Neyveli lignite Corporation Limited*[27] where the question in consideration was characterization of income from a contract of design, manufacture, supply, erection and commissioning of machinery. It may be inferred from that decision that when a payment made for machinery and the supply of design, etc., the supply of design is only incidental to the sale of machinery in order to utilize the machine in the best possible manner, and there is no license or a patent involved which could possibly change the character of income form business profits to royalty income.

It is also interesting to note that a similar position has been independently taken by the US in its specific regulations for the tax treatment of certain transactions involving the transfer of computer programs[28].

The Bangalore Income Tax Appellate Tribunal in its ruling in the landmark decision in the case of *Wipro Ltd. v Income Tax Officer*[29] examined the above issue. In this case, payments were made towards the right to access a database of business data collated, collected and maintained by Gartner, an international agency. The issue was with regard to the characterization of the income of Gartner, from payments made towards access to the database. It was held that, the access to a database containing copyrighted information was not equivalent to a right in a copyright because:

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[26] 238 ITR 296(AAR)

[27] 243 ITR 459

[28] Treas. Regs,. Dec. 1.861-18 *(effective from October 2, 1998)*

[29] 278 ITR 57

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"There is no license granted to the assessee to use in any manner or quote to anyone else. The payment is for obtaining data and use in the way assessee wants it to be used. It is for use of a copyrighted article and not for transfer of right in the copyright in the article."

Therefore it was held that the payments made to Gartner were not in the nature of royalty, but in the nature of the business income of Gartner.

Moving towards the sale of software, the ITAT more recently, in the case of *Lucent Technologies Hindustan v ITO*[30] held that where software is integrated with the hardware, it has been held that such acquisition of software would be inextricably linked to the acquisition of hardware, and thus, the income from software should be treated as sale of goods and cannot be characterized separately as royalty income.

The issue of whether software is a good or service has come up in a number of cases in direct as well as sales taxation of software. The Supreme Court of India settled the matter in the *Tata Consultancy Services v. the State of Andhra Pradesh*[31] case when it held that the sale of off-the shelf software was in the nature of sale of goods and not provision of services. In determining whether off-the-shelf software is a 'good', the Supreme Court held that intellectual property in the software remains with the creator of the software, even though the software was been purchased, and therefore payments for such purchases cannot be held as royalty.

[30] 270 ITR 62 (AT)
[31] 271 ITR 401

The classification of shrink wrap software as goods, also lead to the issue of whether income from sale of such shrink wrap software stored in compact discs or provided by way of limited license etc, will be characterized as business income or whether it will be the royalty income of the software provider.

The issue came up in the case of *Samsung Electronics Company Ltd. v. Income Tax Officer*[32] where the software for telecommunication system, for office appliances, for computer systems and for mobile devices, etc. were developed for the assessee, who made payments without withholding tax, because of which the assessee was charged as an assessee in default. The question was with regard to the taxability of the income of the payee, which would depend on the characterization of payee's income from such software, and whether it would be royalty income. If it were characterized as royalty income it would be taxed at a minimum rate of 10% as per the Income Tax Act, 1961 ("ITA") whereas if it were business income it would not be taxed in India as there was a DTAA and the assessee did not have a PE in India.

The Bangalore ITAT held that, "the assessee had acquired a readymade off the shelf computer program for being used in its business. No right was granted to the assessee to utilize the copyright of the computer program. The incorporeal right to software i.e., copyright remained with the owner and the same was not transferred to the assessee." Therefore, the assessee could not be said to have acquired a right to exploit a copyright, but had merely been sold a copyrighted article/good. The ITAT further referred to copyright law of the USA to draw a distinction between payment for copyright and

[32] (2005) 276 ITR 1 (AT)

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copyrighted article stating that under the US law, the term 'copyright' would mean the right to reproduce copyrighted work or to prepare derivative works or to distribute copies of the copyrighted work and that mere making of a copy of the computer program which is a copyrighted work does not amount to use of copyright provided such copy is necessary for utilization of the computer or for archival purposes only. For this reason the income from the transaction would be business income and not royalty, and would therefore not be taxable in India in the absence of a PE.

This was reiterated in the recent case of *Lotus Developments*[33] where the Delhi ITAT reconfirmed the earlier ITAT ruling in the case of Samsung Electronics and continued to maintain the trend of treating sale of packaged software as business profits and not royalty.

Further, in the AAR ruling in the case of *Dun and Bradstreet Espana*[34] which involved the sale of business information reports (BIRs) which were sold on request by Dun and Bradstreet in India, which contained compilations of publicly available information which was also placed on the Dun and Bradstreet database. The question was with regard to whether the reports would be sold with a copyright or as a copyrighted product. The AAR held that a sale of business information reports would be a sale of copyrighted product, as there was no transfer of a right to exploit the copyright in the product.

The landmark judgment of the ITAT in the case of *Motorola, Ericsson and Nokia*[35] discussed the issue of characterization of income from sale of software embedded into hardware in detail and differentiated between a copyright and copyrighted product. It was held that where the sale involves the sale of a copyrighted product the payment involved would be characterized as business income and not royalty, as the right transferred was not the right to exploit the copyright but the right to use the product. References were drawn to the definition of copyright under the Indian copyright act as well as US law and the Official Commentary on the OECD Model tax convention to support the above view.

Therefore, especially in the context of software sales and trade in India, the courts and tribunals alike have gone into a detailed study of existing concepts to reinvent them to suit the changing situation.

Moving away from tax treatment of payments made for e-commerce transactions, tax rulings also have an effect on the satellite transponders providing services to television channels all over the world. In *Asia Satellite Telecommunications Co. Ltd.*[36], as per the definition of royalty in the ITA, it was held that satellite transmissions in India which led to advertisement revenue in India would be a source of business connection for the entity in India, as the footprint of the satellite lay in India. However, more recently, the satellite industry has heaved a sigh of relief as a recent Delhi tribunal judgment has put to rest the controversy surrounding the taxability of satellite services in India. The question involved was around the taxability of the use of transponder facilities provided by PanAmSat International Systems LLC ('PanAmSat' or 'assessee')[37], who owned and operated a global network of

[33] Unreported
[34] (2005) 272 ITR 99 (AAR)
[35] (2005) 96 TTJ (ITAT) 1
[36] (2003) 78 TTJ 489 (Del.)
[37] Unreported

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telecommunication satellites located at a height of around 35,900 kms above the earth. The Delhi Bench while deciding on the case, discussed the moot question on whether the payment of service fee could be held as being provided for the right to use a 'secret process' and rightly upheld the assessee's contentions that there was no secret process involved, and hence the payment could not be held a royalty. The Delhi bench then went further to examine whether the payments could be held as being payments for fee for included services. Fees for included services are taxable in accordance with the provisions of the tax treaty in case such services "*make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plant or design*." Taking judicial precedents into account, it was held that no technical services could be said to have been rendered to the television channels by permitting them to use the transponder facility, and the question of 'making available' technical knowledge know-how could not arise.

Recently in the case of *N.R. Dongre v. Whirlpool Corporation, 1996 5 SCC 714* the Supreme Court of India dealt with the concept of the trans-border reputation of trademarks. The subject matter of this case was the manufacture, sale, and advertisement of washing machines by an Indian company using the trademark "Whirlpool" as part of the name by which it had recently commenced marketing its washing machines. The claim of the foreign company (respondents) was based on prior use of the mark "Whirlpool" and a trans-border reputation indicating that any goods marketed with the use of the mark "Whirlpool" gave the impression of it being goods marketed by the foreign company; and the washing machines manufactured, sold, and advertised by the Indian company gave that impression, resulting in confusion arising amongst the consumers and the members of the trade. The foreign company sought a temporary injunction, which was granted by the Delhi High Court and upheld by the Supreme Court of India. This case is considered to be a landmark ruling in India because it acknowledged the concept of the trans-border reputation. This judgment has been relied upon successfully in a number of decisions passed by Indian courts. International trademarks, having no actual presence in India, can now be enforced in India if a trans-border reputation with respect to such trademarks exists.

Conclusion

It is evident that Indian tax law has been an active participant in the development of international tax jurisprudence, especially over the last decade or so. If the last few years are an indication of any sort, it can definitely be said with conviction that Indian tax jurisprudence has been and is making some weighty contributions to the international jurisprudence relating to taxation. Precedence has shown that the Indian tax jurisprudence has constantly strived to be on the international forefront and establish a global uniform basis for settling tax disputes.