

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI L BENCH, MUMBAI**

[Coram: Pramod Kumar AM and Pawan Singh JM]

I.T.A. No. 2284/Mum/2014
Assessment year: 2009-10

Interroute Communications Limited**Appellant**
*C/o. Paricewaterhousecoopers Pvt. Ltd.,
PWC House, Plot 18/A,
Guru Nanak Road (Station Road),
Bandra (West),
Mumbai – 400 050 [PAN: AACCI5304G]*

Vs.

Deputy Director of Income Tax**Respondent**
International Taxation 3(1), Mumbai

Appearances by:

Kanchan Kaushal *for the appellant*
Harshad Vengurlekar *for the respondent*

Date of concluding the hearing : January 6, 2016
Date of pronouncing the order : March 31st, 2016

O R D E R

Per Pramod Kumar, AM:

1. By way of this appeal, the assessee appellant has called into question correctness of the order dated 31st October 2013 passed by the CIT(A) in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2009-10.

2. Grievances raised by the assessee appellant are as follows:

1. On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in upholding the action of the AO of treating the revenue of Rs 6,15,32,756 received from the Indian customers during the year under consideration as 'royalty' as per the provisions of Section 9 of the Income Tax Act, 1961 and the treaty between India and United Kingdom, without appreciating that the revenue is in the nature of business income not taxable in India since the appellant does not have a permanent establishment (PE) in India.

2. On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in upholding the action of the learned AO in alternatively treating the revenues of Rs 6,15,32,756 received from the Indian customers

during the year under consideration as ‘fees for technical services’ as per the provisions of Section 9 of the Act, and the DTAA, without appreciating that the revenue is in the nature of business income not taxable in India since the appellant does not have a permanent establishment (PE) in India.

3. The assessee before us is a UK tax resident company engaged in the business of providing international telecommunication network connectivity facility to various telecom operators around the world. The assessee filed a NIL income tax return in India, which was subjected to scrutiny assessment proceedings. During the course of these proceedings, the Assessing Officer noticed that the assessee has received a sum of Rs 6,14,20,596 from Vodafone Essar South Limited, and a sum of Rs 1,12,160 from Tata Telecommunications Ltd, towards the use of virtual voice network (VVN). This VVN, according to the assessee, is a standard facility provided by the assessee to various customers for providing the interconnect to third party carriers through assessee's port. The assessee's stand was that since no part of the work is carried out in India and since all the infrastructure and equipment is situated outside India, the income in question is not taxable in India. These submissions, however, did not impress the Assessing Officer. He held that these receipts are taxable on the basis of his analysis as follows:

“5. The submission of the assessee was carefully considered. It is observed that the assessee is providing VVN services to its customers worldwide. In addition to the VVN it also provides a host of other services which are central to any modern telecommunication service provider around the world. In the instant case, assessee is mainly deriving income from allowing usage of its services/equipment/infrastructure to Vodafone Essar South Limited and to a small extent from Tata Communication Ltd.

6. Interoute is not merely providing port connection. What it is providing is usage of its facilities/infrastructure enabling its customers to interconnect with each other. This includes proprietary software and hardware, technical expertise and other intellectual property held by Interoute.

7. Interoute's Virtual Voice Network (VVN) enables carriers to enter the voice services market without incurring high fixed startup costs and instead uses a pay-as-you-grow model based on monthly fees. Interoute is using next-generation voice technology to offer customers an outsourced VoIP service, which it calls it VVN (Virtual Voice Network).

8. Interoute is not merely providing a standard facility. In other words it is not passively providing a hardware interlace to its customers but it is actively providing the usage of its typical hardware and software proprietary product to facilitate and leverage the core

business of its customers. It includes infrastructure/facilities which enforces call admission control, provides an integrated firewall for real-time services and protects customer's traffic. Whether voice calls are incoming or outgoing, it ensures only authorized calls have access to the network.

9. Interoute has created the World's first commission free voice exchange; giving its customers the ability to exchange traffic securely and flexibly with other operators around the world. Based on the latest VoIP technology and operating over the densest international soft switching platform. Arena is a free trading and interconnects service to operators across the globe. Being part of Arena means no more charges for trading customers traffic to unknown carriers at trading houses; with a no per minute transaction charge, the customer can trade for free with a large community of carriers around the Globe. Via Interoute's secure Web Portal, customers can join a public domain or create their own private ones, giving them the ability to openly and honestly select who and when they wish to trade traffic with.

10. Arena uses Call Admission Control at the border of customer's network which means they can prioritize traffic streams coming into their network and reject unprofitable calls before they reach their Switching platform. Enabling them to prioritize important customers traffic streams, ensuring they receive their high quality supplier capacity. Arena acts as a meeting point to operators around the world; meaning they can gain access to Arena partners wherever they may be located - so trading with them outside existing geography becomes very simple and low cost. Arena is based on soft switching platform which means customers can use VoIP to seamlessly interconnect with everyone and cut the maintenance of huge numbers of costly inflexible TDM interconnects. Arena avoids the problem »f having to allocate fixed capacity to all their partners, reducing costs of customer's network. Arena adds further value to customer's network as their interoperability, connection and management of multiple VoIP interconnect problems will be smoothed away by Interoute's expert VoIP teams, therefore saving them recruiting their own expensive VoIP employees. Arena gives customer's immediate interconnection to over 250 Telehouses in sixteen countries, at no additional cost meaning significant savings in Local loop, international bandwidth and Telehousing.

11. From the above observation, it is apparent that Interoute is not merely renting out its dedicated ports to its customers, The entire physical and virtual infrastructure coupled with the Technical expertise which the assessee possesses is made use of, in providing the seamless interconnectivity to its customers across geographical locations. The usage of such facilities amount to usage of the Intellectual property held by the assessee. The payments made by the customers, is for its usage and involves monthly/cyclic payments. It is also to be noted that availing of this facility has a direct link/bearing on the profitability of its customers i.e. (Vodafone India), who can substantially reduce their operating cost by availing the facility/services provided by the assessee. In view of the above, it is therefore held that the payments received by the assessee is in the nature of Royalty or alternatively as FTS and is to be taxed accordingly.”

4. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. Learned CIT(A) confirmed the stand of the Assessing Officer, and observed as follows:

“7. I have considered the AO's order as well as the appellant's AR submission. Having considered both, I find that the appellant is trying to mislead the incidence of chargeability of tax on receipt arisen from the Indian Customer to the appellant on merely stating that the appellant is a non-resident and all the infrastructure is also situated outside India. Hence the same cannot be termed as 'Royalty' or 'Fee' for technical services. But having taken note of the AO's order, I am completely in agreement with the AO's finding that the entire payment which has been made by the Indian Customers to the appellant is in the nature of 'Royalty' or 'Fee' for technical services' as the appellant is creating a product which allows its customers in India to link its networks to that of other networks in Europe/USA, it is not a simple case where a customer is using a standard facility provided by Interoute i.e. the appellant. The appellant is providing entire services to the Indian customers to make them effectively enable them to interconnect with the net work of Europe and USA. The entire services which has been provided by the appellant is highly technical and is in the nature of services which has been rendered by the appellant to the Indian customers and for that only such payments have been made. Having taken note of the Article of India-UK-DTAA on royalty and fee for technical services and also to Sec.9 of the income-tax Act, I am in complete agreement with the AO's finding that these payments are in the nature of royalty or fee for technical services. Accordingly, I consider it proper and appropriate to hold that the reasoning assigned by the AO for taxability of such receipt in the hands of the appellant in India is completely justified and correct as per the provisions of law. Accordingly, the addition so made by the AO of Rs.6,15,32,756/- is confirmed. The appellant's these grounds of appeal are dismissed.”

5. The assessee is not satisfied and is in further appeal before us.

6. We have heard the rival submissions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

7. It is only elementary that the provisions of the Indian Income Tax Act, 1961, in the case of an assessee eligible for treaty benefits, can be pressed into service only when these are more beneficial to the assessee vis-à-vis the applicable treaty provisions. In a situation, therefore, in which the assessee is not exigible to tax under the provisions of the applicable tax treaty, there is no occasion to examine the taxability under the provisions of the Act. The assessee before us, being a tax resident of the United Kingdom, is eligible to avail benefits of the India UK Double Taxation Avoidance Agreement [(1994) 206 ITR (Statute) 235; Indo UK tax treaty, in short]. There is no dispute that the assessee does not have any permanent establishment in India, and, therefore, the business profits earned by the assessee cannot

be brought to tax in India. The taxability, if at all in the present fact situation, can only be under article 13, and it is under this article that the assessee's income from India is held, by the authorities below, to be taxable in India. It is in this light that we begin by taking a look at the relevant treaty provision, i.e. Article 13. This is as follows:

ARTICLE 13

Royalties and fees for technical services

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties within paragraph 3 (a) of this Article, and fees for technical services within paragraph 4 (a) and (c) of this Article;

(i) during the first five years for which this Convention has effect;

(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and

(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services;

and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

(3) For the purposes of this Article, the term "royalties" means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) which :

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

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this article is received; or

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

5. The definitions of fees for technical services in paragraph 4 of this article shall not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid

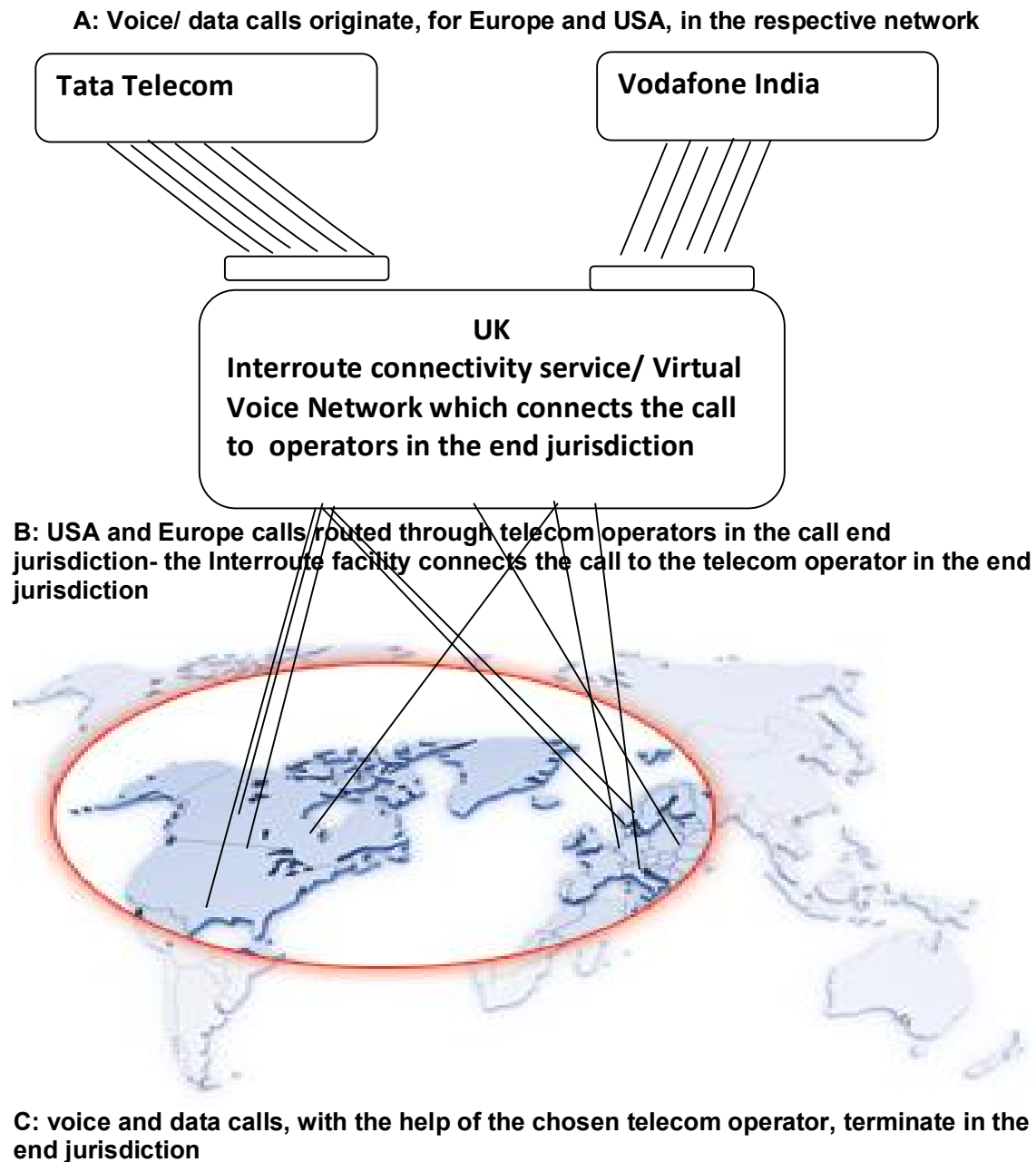
is effectively connected with such permanent establishment or fixed base. In such case, the provision of Article 7 (Business profits) or Article 15 (Independent personal services) of this convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borne by that permanent establishment or fixed base then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment

8. So far as taxation of the receipts in question as royalty, under the above treaty provision, is concerned, it can only be in the two situation- (a) first, when it is %a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience+; and (b) when it is a consideration for the use of, or the right to use, any industrial, commercial or scientific equipment+. However, in order to understand whether the income in question will fit into any of the above descriptions, it is necessary to understand the nature of service provided by the assessee. By way of a diagram, this service can be described as follows:



9. Essentially, the role played by the interroute facility is connecting the call to the end operator, and, in that sense, it works like a clearing house. Similarly, in the case of incoming calls, calls originating from Europe and USA, which are to end in India, are routed to the respective operators. In the present fact situation, the payment made by the Indian entities can be held to be royalty only when it is payment for scientific work, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. It is not for a payment for a scientific work nor there is

any patent, trademark, design, plan or secret formula or process for which the payment is made. There can hardly be any dispute that the payment is made for a service, which is rendered with the help of certain scientific equipment and technology, rendered by the assessee. The service is connectivity to the telecom operators in the call end jurisdiction. The facility is a standard facility which is used by other telecom companies as well. As for the dedicated ports, these things only provide a certain level of capacity in access but the payment is for the service nevertheless. Merely because the payment involves a fixed as also a variable payment does not alter the character of service. Dealing with such a type of consideration, a coordinate bench of this Tribunal, in the case **Kotak Mahindra Primus Ltd Vs DDIT [(2007) 11 SOT 578 (Bom)]**, had held that **“this type of pricing of a service, by segregating the fixed and variable price, is not unusual**+. That does not, however, alter the character of arrangement. The payment continues to be for service alone. The assessee may charge a fixed amount to cover its costs in employing enhanced capacity so as not to incur losses when this capacity is not used, but what the customer is paying for is a service and not the use of equipment involved in additional capacity, nor, as we have seen above, for any scientific work, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. It cannot, therefore, be axed as royalty under article 13 of the Indo UK tax treaty. The payment for a service can be brought to tax under article 13 only when it makes available the technology in the sense that recipient of service is enabled to perform the same service without recourse to the service provider. As held by this Tribunal, in the case of **CESC Ltd Vs DCIT [(2003) 87 ITD TM 653 (Kol)]**, “..... in order to be covered by the provisions of art. 13(4)(c) of the India UK DTAA, not only the services should be of technical in nature but such as to result in making the technology available to the person receiving the technical services. We also agree that merely because the provision of the service may require technical input by the person providing the service, it cannot be said that technical knowledge, skills, etc. are made available to the person purchasing the service. As to what are the connotations of 'making the technology available to the recipient of technical services', as is appropriately summed up in protocol to Indo-US DTAA, "generally speaking, technology will be considered 'made available' when the person acquiring the service is enabled to apply the technology." In the case before us, no services are made available in the sense that the recipient of service is enabled to apply the technology, and do the same work without recourse to the service provider. There is no transfer of technology here, and in that sense technical services are not made available. Undoubtedly, the services rendered by the assessee

requires technical inputs, but that alone, as we have seen above, does not bring it in the ambit of fees for technical services taxable under article 13 of India UK tax treaty.

10. In view of the above discussions, as also bearing in mind entirety of the case, we are of the considered view that the authorities below were in error in holding that the receipts of Rs 6,15,32,756, from Indian entities on account of connectivity charges, are taxable in India. We direct the Assessing Officer to delete the same.

11. In the result, the appeal is allowed. Pronounced in the open court today on 31st day of March, 2016

Sd/-
Pawan Singh
(Judicial Member)

Sd/-
Pramod Kumar
(Accountant Member)

Dated: 31st day of March, 2016.

Copies to: (1) The appellant (2) The respondent
(3) Commissioner (4) CIT(A)
(5) Departmental Representative (6) Guard File

By order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai