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Bandwidth Charges- Royalty or Not? Need Another SC Judgement

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On 2.3.2021, hearing almost 80 civil appeals simultaneously, the Hon'ble Supreme Court in its landmark judgment in the case of ***"Engineering Analysis Centre of Excellence (P.) Ltd.* v. *CIT"*** [2021] 125 taxmann.com 42, has put to rest the ages old litigation and conundrum concerning the taxability or otherwise of software as royalty, by holding that the payments made by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale of the computer software through End User License Agreements (EULAs)/distribution agreements, can't be considered as payment of royalty for the use of copyright in the computer software as per provisions of Article 12(3) of the applicable DTAAs and further that the provisions contained in section 9(1)(vi) of the Income Tax Act along with explanations 2 and 4 thereof, not being more beneficial to the assessees, will not have any application.

Like the issue of taxability of software as royalty, another very contentious and litigative issue which requires another landmark judgment from the Hon'ble Supreme Court, to be put to rest, is the issue of taxability or otherwise of Bandwidth Charges as Royalty.

Bandwidth in normal parlance refers to the amount of traffic that could be carried on the internet. Greater the bandwidth greater would be the ability to transmit data and other communication.

Bandwidth is bought and sold to consumers and it acts as a conduit only.Satellite operators and their customers (including broadcasting and telecommunication enterprises) frequently enter into transponder leasing agreements under which the satellite operators allow the customers to utilise the capacity of a satellite transponder to transmit over large geographical areas. Payments made by customers under typical transponder leasing agreements are made for the use of the transponder transmitting capacity of the satellite operators.

Indian Revenue Authorities generally tend to consider the payments made by Indian resident customers to the non-resident satellite operators towards availing the standard bandwidth facility or capacity of the satellite transponders as royalty within the meaning of section 9(1)(vi) read with Explanations 2, 5 and 6 of the Income Tax Act, 1961.

For ready reference, the bare text of section 9(1)(vi) read with Explanations 2, 5 and 6 of the Income Tax Act, 1961 is reproduced below:

> "9. (1) The following incomes shall be deemed to accrue or arise in India :—

(*vi*) income by way of royalty.....

Explanation 2.—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 section 44BB;

(*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*).

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(*a*) the possession or control of such right, property or information is with the payer;

(*b*) such right, property or information is used directly by the payer;

(*c*) the location of such right, property or information is in India.

***Explanation 6.*—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;" (emphasis supplied)**

It is pertinent to mention here that Explanations 5 and 6 have been inserted by the Finance Act 2012, with retrospective effect from 1.6.1976.

The Hon'ble Madras High Court in the case of ***"Verizon Communications Singapore Pte Ltd."* v. *ITO*** [2013] 39 taxmann.com 70/[2014] 224 Taxman 237 (Mag.)/361 ITR 575relying upon above insertions of Explanations 5 and 6 to section 9(1)(vi) of the Income Tax Act, by the Finance Act 2012, has held that payment made by Indian customers to a Singapore company for providing end-to-end internet connectivity (bandwidth services) outside India was taxable as royalty under the Income Tax Act.

So, the revenue authorities generally contend that the payment towards bandwidth charges made by Indian resident customers to non-resident satellite operators for availing the standard facility of satellite transponder capacity is taxable in India as royalty by virtue of Explanation 6 to section 9(1)(vi) of the Income Tax Act.

However, it is a Trite Law that in determining the question of taxability or otherwise, of such international transactions as royalty in India, the provisions of applicable Double Taxation Avoidance Agreements (DTAAs) are also to be considered along with the Income Tax Act provisions and the provisions as contained in Income Tax Act or the applicable DTAA, which are more beneficial to the assessee will have overriding application (section 90(2) of the Income Tax Act read with Explanation 4).

This Trite Law has once again been reaffirmed by the Hon'ble Supreme Court in the above-mentioned decision in the case of *Engineering Analysis Centre of Excellence (P.) Ltd.* (*supra*), by holding as under:

> "25....."Certain income is deemed to arise or accrue in India, under section 9 of the Income Tax Act, notwithstanding the fact that such income may accrue or arise to a non-resident outside India. One such income is income by way of royalty, which, under section 9(1)(vi) of the Income Tax Act, means the transfer of all or any rights, including the granting of a licence, in respect of any copyright in a literary work.
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> 26. That such transaction may be governed by a DTAA is then recognized by section 5(2) read with section 90 of the Income Tax Act, making it clear that the Central Government may enter into any such agreement with the government of another country so as to grant relief in respect of income tax chargeable under the Income Tax Act or under any corresponding law in force in that foreign country, or for the avoidance of double taxation of income under the Income Tax Act and under the corresponding law in force in that country. What is of importance is that once a DTAA applies, the provisions of the Income Tax Act can only apply to the extent that they are more beneficial to the assessee and not otherwise. Further, by *explanation* 4 to section 90 of the Income TaxAct, it has been clarified by the Parliament that where any term is defined in a DTAA, the definition contained in the DTAA is to be looked at. It is only where there is no such definition that the definition in the Income Tax Act can then be applied. This position has been recognised by this Court in ***Azadi Bachao Andolan*** (*supra*), which held:
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> "**21.** The provisions of Sections 4 and 5 of the Act are expressly made "subject to the provisions of this Act", which would include Section 90 of the Act. As to what would happen in the event of a conflict between the provision of the Income Tax Act and a notification issued under Section 90, is no longer res integra."
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> **"28.** A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that Section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement. When that happens, the provisions of such an agreement, with respect to cases to which they apply, would operate even if inconsistent with the provisions of the Income Tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under Section 4 and the general principle of ascertainment of total income under Section 5 of the Act, then there was no purpose in making those sections "subject to the provisions of the Act". The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under Section 90 towards implementation of the terms of DTACs which would automatically override the provisions of the Income Tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of DTAC." (emphasis supplied)
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> ** ** **
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> "42. The subject matter of each of the DTAAs with which we are concerned is income tax payable in India and a foreign country. Importantly, as is now reflected by *explanation* 4 to section 90 of the Income Tax

Act and under Article 3(2) of the DTAA, the definition of the term "royalties" shall have the meaning assigned to it by the DTAA, meaning thereby that the expression "royalty", when occurring in section 9 of the Income Tax Act, has to be construed with reference to Article 12 of the DTAA. This position is also clarified by **CBDT Circular No. 333 dated 02.04.1982,31** which states as follows:

"Circular: *No. 333 dated 2-4-1982.*

Specific provisions made in double taxation avoidance agreement - Whether it would prevail over general provisions contained in Income-tax Act

1. It has come to the notice of the Board that sometimes effect to the provisions of double taxation avoidance agreement is not given by the Assessing Officers when they find that the provisions of the agreement are not in conformity with the provisions of the Income-tax Act, 1961.

2. The correct legal position is that where a specific provision is made in the double taxation avoidance agreement, that provisions will prevail over the general provisions contained in the Income-tax Act. In fact that the double taxation avoidance agreements which have been entered into by the Central Government under section 90 of the Income-tax Act, also provide that the laws in force in either country will continue to govern the assessment and taxation of income in the respective countries *except* where provisions to the contrary have been made in the agreement.

3. Thus, where a double taxation avoidance agreement provides for a particular mode of computation of income, the same should be followed, irrespective of the provisions in the Income-tax Act. Where there is no specific provision in the agreement, it is basic law, i.e., the Income-tax Act, that will govern the taxation of income." (emphasis supplied).

Therefore, in view of the above well-settled and established position of Law, the question of taxability or otherwise of the receipts of bandwidth charges as royalty in the hands of non-resident satellite operators can be answered judicially only after giving due consideration and cognizance to the definition of royalty in the applicable DTAAs.

Currently India has signed DTAAs with many Countries and the prominent ones are United States of America, Republic of Singapore, Commonwealth of Australia, Canada, People's Republic of China, Republic of Cyprus, Republic of Finland, Republic of France, Federal Republic of Germany, Hong Kong Special Administrative Region of the People's Republic of China, Republic of Ireland, Republic of Italy, Japan, Republic of Korea, Kingdom of Netherlands, Kingdom of Sweden, India-Taipei Association in Taipei (Taiwan), United Kingdom of Great Britain and Northern Ireland.

Each of these DTAAs is based on the OECD Model Tax Convention on Income and on Capital, and are therefore substantially similar, if not identical, in respect of the provisions concerning "business profits" and "royalties".

The definition of Royalty as envisaged in one of these DTAAs, namely the India-Singapore DTAA, is reproduced as follows:

"**ARTICLE 12 - ROYALTIES AND FEES FOR TECHNICAL SERVICES**

3. 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:

(*a*) any copyright of a literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret

formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information;

(*b*) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8."

It is duly evident from the above reproduced definition of 'Royalty', in the DTAAs with prominent countries, that the definition of 'Royalty' as contained in these DTAAs is much narrower in its scope and coverage than the definition of 'Royalty' as contained in section 9(1)(vi) read with Explanations 2, 5 and 6 of the Income Tax Act.

It is also clearly evident that the extended scope and coverage of the definition of 'Royalty' as per Explanation 6 to section 9(1)(vi) of the Income Tax Act, so as to include the process of 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, within the meaning of 'Royalty', has not found any similar extension in the scope and coverage of the definition of 'Royalty' in the above DTAAs.

So, the definition of 'Royalty' as contained in section 9(1)(vi) along with Explanations 2 and 6 of the Income Tax Act, not being more beneficial to the assessees, will have no application. In other words, the much narrower definition of 'Royalty' as per the DTAAs will have over-riding application over the provisions contained in section 9(1)(vi) of the Income Tax Act, by virtue of legislative provisions contained in section 90(2) read with Explanation 4 of the Income Tax Act.

On perusal of the definition of 'Royalty' as envisaged in the above DTAAs, it becomes amply clear that the payments towards bandwidth charges to non-resident satellite operators can't be construed as 'Royalty', because the availment of the benefits of a standard facility i.e., satellite transponder's capacity of satellite operators, by the Indian resident customers, can't be considered as the "use or the right to use the satellite transponder" so as to consider it as royalty.

Mere collection of a fee for making available a standard facility provided to all those willing to pay for it does not amount to granting the use or right to use any process, or industrial or commercial or scientific equipment, so as to be construed as royalty.

Installation & operation of sophisticated equipments or a standard facility with a view to earn income by allowing the users to avail the benefits of such equipments or standard facility does not tantamount to granting the use or the right to use that equipment or process so as to be considered as royalty within the above definition of 'royalty' contained in clause 3(a) of Article 12 of the DTAAs with abovementioned prominent countries.

Further, under such agreements, the ownership, control, operation and management of the standard facility i.e., satellite transponder's capacity, always remains with the non-resident satellite operators and at no point of time, the Indian resident customers gain any possession or physical custody, control or management over the operation of such satellite transponder, so as to use or obtain the right to use such satellite transponder, and in the absence of any such use or the right to use, the payments of bandwidth charges can't be considered as 'Royalty'.

Also, the process involved to provide the bandwidth service is not "secret", but a standard commercial process followed by the industry players. Therefore, the said process can't be classified as a "secret process", as is required by the above- mentioned clause 3(a) of Article 12 of the governing DTAAs.

The Hon'ble Authority for Advance Ruling in the case of ***Dell International Services India (P.) Ltd.*, In re [2008] 172 Taxman 418/[2009] 305 ITR 37**, has held as that,

> ***"12.8. The word 'use' in relation to equipment occurring in (iv.a) is not to be understood in the broad sense of availing of the benefit of an equipment. The context and collocation of the two expressions 'use' and 'right to use' followed by the word "equipment" suggests that there must be some positive act of utilization, application or employment of equipment for the desired purpose.***
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> ***If an advantage is taken from sophisticated equipment installed and provided by another, it is difficult to say that the recipient/customer uses the equipment as such. The customer merely makes use of the facility, though he does not himself use the equipment."***

The assessees can also place their reliance on the judgments of the Hon'ble Delhi High Court in the case of ***DIT* v. *New Skies Satellite BV* [2016] 68 taxmann.com 8/238 Taxman 577/382 ITR 114 and *CIT* v. *Siemens Aktiongesellschaft* [2009] 177 Taxman 8/310 ITR 320 (Bom.)**.

Similar reliance can be placed upon the decisions of:

(*i*) ***Dy. CIT* v. *Reliance Jio Infocomm Ltd.* [2019] 108 taxmann.com 325 (Mum.), wherein it has been held that:**

S. 9(1)(vi) Royalty: Payment for 'bandwidth services' is not assessable as 'royalty' if the assessee only has access to services and not to any equipment. The assessee also did not have any access to any process which helped in providing of such bandwidth services. All infrastructure & process required for provision of bandwidth services was always used and under the control of the service provider and was never given either to the assessee or to any other person availing the said services.

(*ii*) ***Cable & Wireless Networks India (P.) Ltd.*, In re [2009] 182 Taxman 76/315 ITR 72 (AAR);**

(*iii*) ***ITO* v. *Sify Ltd.* [IT Appeal Nos. 1277 & 1283 (Mad.) of 2008, dated 2-2-2012];**

(*iv*) ***Software Technology Parks of India* v. *ITO* [2005] 3 SOT 529 (Bang.);**

(*v*) ***Wipro Ltd.* v. *ITO* [2004] 1 SOT 758 (Bang.);**

(*vi*) ***Dy. CIT* v. *Infosys Technology Ltd.***

(*vii*) ***Geo Connect Ltd.* v. *Dy. CIT* [2017] 88 taxmann.com 758 (Delhi - Trib.)**

It is further interesting to note that the above well settled legal position that the payment towards bandwidth charges can't be considered as Royalty, has been fully endorsed by the International Governing Body for all international transactions i.e.,**Organisation for Economic Co-operation and Development (OECD) in para 9.1 of OECD Model Commentary** as under:

> "9.1 Satellite operators and their customers (including broadcasting and telecommunication enterprises) frequently enter into transponder leasing agreements under which the satellite operator allows the customer to utlise the capacity of a satellite transponder to transmit over large geographical areas. Payments made by customers under typical transponder leasing agreements are made for the use of the transponder transmitting capacity and will not constitute royalties under the definition of paragraph 2; these payments are not made in consideration for the use of, or the right to use, property, or for information, that is referred to in the definition of paragraph 2 of Article 12; they cannot be viewed, for instance, as payments for information or for the use of, right to use, a secret process since the satellite technology is not transferred to the customer."

Any discussion or analysis on this crucial and sensitive issue can't get completed without analyzing the rationality, objectivity and more importantly the legal sanctity of inserting Explanations 5 and 6 to section 9(1)(vi) of the Income Tax Act, by Finance Act 2012, retrospectively w.e.f. 1.6.1976.

The Hon'ble Supreme Court in the above-mentioned decision in the case of ***"Engineering Analysis Centre of Excellence (P.) Ltd.* (*supra*),** has analysed the issue of legal sanctity of similar retrospective insertion of Explanation 4 to section 9(1)(vi) by the Finance Act 2012, w.e.f. 1.6.1976, in determining the question of taxability of software as royalty, and has held as follows:

> "80. The learned Additional Solicitor General then argued that being covered by *explanation* 4 of section 9(1)(vi) of the Income Tax Act, the persons liable to deduct TDS under section 195 of the Income Tax Act ought to have deducted tax at source on the footing that *explanation* 4 existed on the statute book with effect from 1976. We have, therefore, to examine as to whether persons liable to deduct TDS under section 195 of the Income Tax Act can be held liable to deduct such sums at a time when *explanation* 4 was factually not on the statute book, all deductions liable to be made and the assessment years in question being prior to the year 2012.
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> 81. This question is answered by two latin maxims, ***lex non cogit ad impossibilia,* i.e., the law does not demand the impossible and *impotentia excusat legem,* i.e., when there is a disability that makes it impossible to obey the law, the alleged disobedience of the law is excused.** Recently, in the judgment in ***Arjun Panditrao Khotkar* v. *Kailash Kushanrao Gorantyal* [2020] 7 SCC 1** delivered by this Court, this Court applied the said maxims in the context of the requirement of a certificate to produce evidence by way of electronic record under section 65B of the Evidence Act, 1872 and held that having taken all possible steps to obtain the certificate and yet being unable to obtain it for reasons beyond his control, the respondent in the facts of the case, was relieved of the mandatory obligation to furnish a certificate.
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> **.....85. It is thus clear that the "person" mentioned in section 195 of the Income Tax Act cannot be expected to do the impossible, namely, to apply the expanded definition of "royalty" inserted by *explanation* 4 to section 9(1)(vi) of the Income Tax Act, for the assessment years in question, at a time when such *explanation* was not actually and factually in the statute. " emphasis supplied**

Concluding Remarks: Though the above analysis, reasoning and justification for non-consideration of the payments of bandwidth charges made by Indian resident customers to non-resident satellite operators as royalty stands and musters the scrutiny and test of Law, but nonetheless this unnecessary controversy surrounding this contentious and litigative issue, can also be put to rest only by another landmark judgment of the Hon'ble Supreme Court like that of its very recent judgment in the case of ***Engineering Analysis Centre of Excellence (P.) Ltd.* (*supra*)** concerning the issue of taxability of software as royalty.

Sincerely hope and wish that the assessee **"Verizon Communications Singapore Pte Ltd."** comes across this Taxalogue and wins its appeal before the Hon'ble Supreme Court against the judgment of the Hon'ble Madras High Court.

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