

# Taxation of E-commerce Companies



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- E-Commerce under different business models
  - Company who is Running Platform
  - Company which is doing buying & selling
  - Company Handling Logistics
- Payment Gateway
- Issues & Problems in Taxing E-commerce Transactions
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- E-commerce under FDI Policy

# E-Commerce

- E-commerce is basically buying / selling of products/ provision of services by businesses through an electronic medium not requiring any human interface.



# E- commerce companies

The buying and selling of products and services by businesses and consumers through an electric medium, without using any paper documents. E-commerce is widely considered the buying and selling of products over the internet, but any transaction that is completed solely through electronic measures can be considered e-commerce. E-Commerce can be sub-divided into three categories: business to business or B2B (Cisco), business to consumer or B2C (Amazon), and consumer to consumer or C2C (eBay). **also called** electronic commerce.

# EXAMPLES:

- ❑ Amazon selling goods/ software over internet.
- ❑ Investors trading on stock market through website.
- ❑ Foreign telecasting company beaming programs over several countries
- ❑ Google earning advertisements through website
- ❑ Matrimonial websites earning income by connecting people
- ❑ Olx and Quikr create platform for buyers and sellers
- ❑ CA rendering advice on phone

# DIFFERENT MODELS

```
graph TD; A((A. Running Platforms)); B((B. Buying & Selling)); C((C. Handling Logistics));
```

## E- COMMERCE COMPANIES

**A. Running  
Platforms**

**B. Buying &  
Selling**

**C. Handling  
Logistics**

## A. Companies Running Platforms

- In this model, the role of E-Commerce player is to bring buyers and suppliers on single trading platform i.e. to create a Mall or Common Market Place.
- Example of such companies are : Olx, Quikr, grofers etc

# Case Analysis: Olx

- Olx provides an interactive platform to the sellers and buyers, where they meet and transact. Olx does not generally charge from the sellers and buyers unless they opt for listing their products.
- **OLX INDIA PRIVATE LIMITED** is a Unlisted Private company incorporated on 22 May, 2009.



# Contd.....

## □ Major Expenses Incurred

- *Website Developing Expenses*
- *App Developing Expense*
- *Technical Know How Expenses*

## □ Income Sources

- **Google ad sense banner:** OLX uses two Google ad units, one that is persistent throughout on the left side of the site and one right before the listings
- **Sponsored Links:** Sponsored links are those links that you see before organic Google search results. They are always labeled as sponsored links
- **Featured Listings:** A featured Ad on OLX allows your Ad to appear right before all the other advertisements within the same category.

# Contd.....

- Since olx is registered in India, all incomes of Indian company are taxable in India. However, the issue will arise in case of :
  - ▣ **Payments Made to Non residents**
    - Check applicability of section 195 of Income Tax Act, 1961
    - Check provisions of DTAA with the other country where payment rendered.
    - Check provisions for 15CA/ 15CB [specially after 1<sup>st</sup> June, 2015]
  - ▣ **Income Received from Non Residents**
    - Check the nature of Income, if taxable in India
    - Check provisions of DTAA with other country from where income received
    - Check TDS provisions

## **B. Companies Buying & selling**

- In this model, E-Commerce player control end to end value chain i.e. right from procurement to delivery is controlled by service provider. These type of companies issue invoices in their own name to the customers.
- Examples of such type of e-commerce companies are: Amazon, Flipkart, myntra etc

# Case Analysis: Flipkart

- Flipkart is a type of e-commerce company which buys goods in wholesale for lesser price and sell them online in retail. They just work as a supermarket or a retail shop and make profit on sales but only difference is they sell everything online
- Flipkart India Private Limited is a Private Company incorporated on 19 September 2011. It is classified as Indian Non-Government Company and is registered at Registrar of Companies, Bangalore.

**Contd.....**

❑ **Major Expenses**

- ❑ Website Content Management charges
- ❑ Apps Developing charges
- ❑ Delivery charges/ Shipping cost
- ❑ Buying
- ❑ Customer care service charges

❑ **Income Sources**

- ❑ Income from selling

**Contd.....**

- Since, Flipkart is registered in India it is a resident, all incomes of Indian company are taxable in India. However, the issue will arise in case of :

- **Payments Made to Non residents**

- Check applicability of section 195 of Income Tax Act, 1961
- Check provisions of DTAA with the other country where payment rendered.
- Check provisions for 15CA/ 15CB

- **Income Received from Non Residents**

- Check the nature of Income, if taxable in India
- Check provisions of DTAA with other country from where income received
- Check TDS provisions.

# C. Companies Handling Logistics

In this type of model, the e-commerce companies do not get involved in buying and selling. Their only work is to see delivery, transportation, packing, insurance of the product etc. Examples of such companies are: aramex, delhivery, Naaptol etc

## ON THE MOVE

E-Commerce logistics players and clients



# Case Analysis: Naaptol

- **Naaptol** follows the marketplace business model wherein it facilitates online and offline sales of third party products to its customer base, in addition to handling the customer service. In other words, it provides a platform for merchants and sellers to sell their products through Naaptol so that small-time merchants/sellers can reach out to a wider customer base and customers enjoy great value-for-money Naaptol



# Contd...

## ☐ **Major Expenses**

- ☐ Website Content Management charges
- ☐ Apps Developing charges
- ☐ Delivery charges/ Shipping cost
- ☐ Customer care service charges

## ☐ **Income Sources**

- ☐ Commission from sellers

# Payment Gateways

An electronic payment system, modeled for an e-commerce business, may sound simple – a customer chooses a product to buy online, clicks ‘pay’, enters certain credit card / bank details, and the entire transaction is complete.

However, electronic payment systems are often more complex than traditional payment methods, as they typically involve a number of players

# Payment Gateways

## **Players are :**

- Customer;
- Merchant;
- An issuing bank - the customer's bank;
- An acquiring bank - the merchant's bank;
- Entities such as Master or Visa – typically associations of banks / financial institutions, which provide an array of payment products to financial institutions;
- One or more payment processors / payment gateways - that provide technology for the receipt and processing of payment instructions and settlement, or actually receive and hold funds received from the customer for onward payment to the merchant; and
- Certification authorities, such as Payment Card Industry Security Standards Council.

# Issues & Problems in Taxing E-commerce Transactions

# Issues.....

## □ Legal Difficulty

- No physical movement of goods/ services (e.g. Downloads/ online services etc.)

## □ Nature of Contract

- **Legal enforceability of contract-** Principal place of business or Place of Buyer's Residence?

## □ Taxable Jurisdiction

- **Physical jurisdiction** not possible to derive in most of the e-commerce transactions as transactions carried out through satellite and networks.
- Even **Physical Presence (182 days rule)** is challenged as a person visits a country many times through virtual presence ??
- In E-commerce situations, with transactions being completed in cyberspace, it is often not clear as to the place where the transaction is effected, giving rise thereby to difficulties in implementing source rule taxation.

## □ Characterization of Income

- Whether income earned with respect to the use or sale of goods (*particularly items such as software and electronic databases*), sale of advertising space etc. is royalty or business income or capital gains.

## □ Taxation of income in more than one Country

- Due to the Involvement of people who are resident of more than one country, income arising out of e transactions may be taxed in more than one country.

# Major aspect to be considered for taxation.....

- In absence of national boundaries, physical presence of goods and non requirement of physical delivery, taxation of e-commerce transactions raises several issues. They have to be understood in light of international transactions.
- Structure e-commerce business models to mitigate tax risks, especially risk of taxation in more than one country (*without availability of credit for payment of taxes in countries other than the country of tax residence*).



# Two Spheres of Taxation

## □ Indian Income Tax Act, 1961

- Section 4 – Basis of Charge
- Section 5 – Scope of Total Income
- Section 6 – Residence in India
- Section 9 – Income deemed to accrue or arise in India

## □ Double Taxation Avoidance Agreements [DTAA]

- Notified Treaties of India with various Countries
- Based on OECD/UN/US Model conventions, mutually negotiated between Countries
- Source vs. Residence country taxation rights

# General Aspects of taxation of income under Income Tax Act, 1961

- Under the Income Tax Act, 1961
  - ▣ residents are subject to tax in India on their worldwide income
  - ▣ non-residents are taxed only on income sourced in India.
- As per Section 9, certain types of income (such as interest, royalty, income from any capital asset situated in India, etc), are deemed to accrue or arise in India under prescribed circumstances.
- Relief under tax treaty can be claimed (if available).

## Taxability in traditional Commerce

### Residence Based



Incorporation or  
control &  
management

### Source Based



Characterization  
+ FTS/ Royalty

PE

## Taxability in E- Commerce

### Residence Based



~~Incorporation or  
control &  
management~~

### Source Based



Characterization  
+ FTS/ Royalty

~~PX~~

Place of  
effective  
managem  
ent  
(POEM) ?

Amend  
Permanent  
Establishe  
nt / With  
holding Tax  
rules?

Transac  
tion  
Tax?

# Taxation of income generated by non- residents from e-commerce transactions is subject to .....

- **Characterization of income**: whether income earned with respect to the use or sale of goods (particularly items such as software and electronic databases), sale of advertising space etc is royalty or business income or capital gains
- **Permanent establishment (PE)**: whether presence of a server/other electronic terminal in India, hosting of websites or other technical equipment, etc., constitute PE in India.

- The taxation of income of e-commerce transaction is subject:

## Characterization of income

```
graph TD; A[Characterization of income] --> B[I. Business Income]; A --> C[II. Royalties]; A --> D[III. Fee for professional services];
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**I. Business  
Income**

**II. Royalties**

**III. Fee for  
professional  
services**

**Note: In case, characterisation of Income is not in consonance with international principles, the income may be subject to double taxation (in absence of availability of credit of taxes paid in India).**

# **I. Business Income: Section 9**

- **Section 9(1)(i) of the Act:**

*“The following incomes shall be deemed to accrue or arise in India:-*

*all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.”*

- **Explanation 1(a) to section 9(1)(i) of the Act:**

*“In the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India”*

# Tax Treaty – Business Income

Foreign Enterprise

```
graph TD; A[Foreign Enterprise] --> B[Business Activity carried out in other Contracting State]; B --> C[Taxable<br/>If existence of PE under Article 5]; B --> D[Not Taxable<br/>If No PE exists]; C --> E[Computation of profits dealt<br/>in article 7];
```

Business Activity carried out in other Contracting State

Taxable

If existence of PE under Article 5

Computation of profits dealt  
in article 7

Not Taxable

If No PE exists

**PE- To determine the right of a contracting state to tax the profits of an enterprise of other contracting state.**

# **PE- Permanent Establishment**

**PE is “a fixed place of business through which the business of the enterprise is wholly or partly carried on”**

## **□ Disposal Test**

- PE, if certain amount of space available at disposal**
- Space owned or leased or occupied illegally- IMMATERIAL**
- Mere presence is not conclusive**

## **□ Permanence Test: Should not be temporary**

## **□ Core Functions Test**

- Function contributing to the profit earning capacity should be performed**



# Contd....

- ❑ Includes place of management, branch office, factory, workshop etc [Article 5(2)]
- ❑ Preparatory & Auxiliary (P & A) activities does not constitute PE
- ❑ Installation, construction, assembly or supervisory PE
  - ❑ Subject to duration test
- ❑ **Service PE** – Rendering of services by an enterprise through employees or other personnel for a particular period constitutes PE
- ❑ **Dependent agent PE**
  - ❑ Has or habitually exercises an authority to conclude contracts, or
  - ❑ Has no such authority, but maintains & delivers goods, or
  - ❑ Habitually secures orders wholly or almost wholly for enterprise/group

# **Taxability of non resident who has permanent establishment in India**

- Taxability of such non resident would depend upon:
  - ▣ Where there is a treaty between India and the country of which the recipient of income is resident.
  - ▣ Where there is no treaty

## **Where there is a treaty**

- ▣ In such case, the following provisions whichever beneficial to non resident shall be applicable:
  - (i) Provisions of domestic tax law provided under 9(1)(i)
  - (ii) Provisions of DTAA i.e. article 5 read with article 7

However, in both the cases so much profit shall be taxable in India which can reasonably be attributed to such operations.

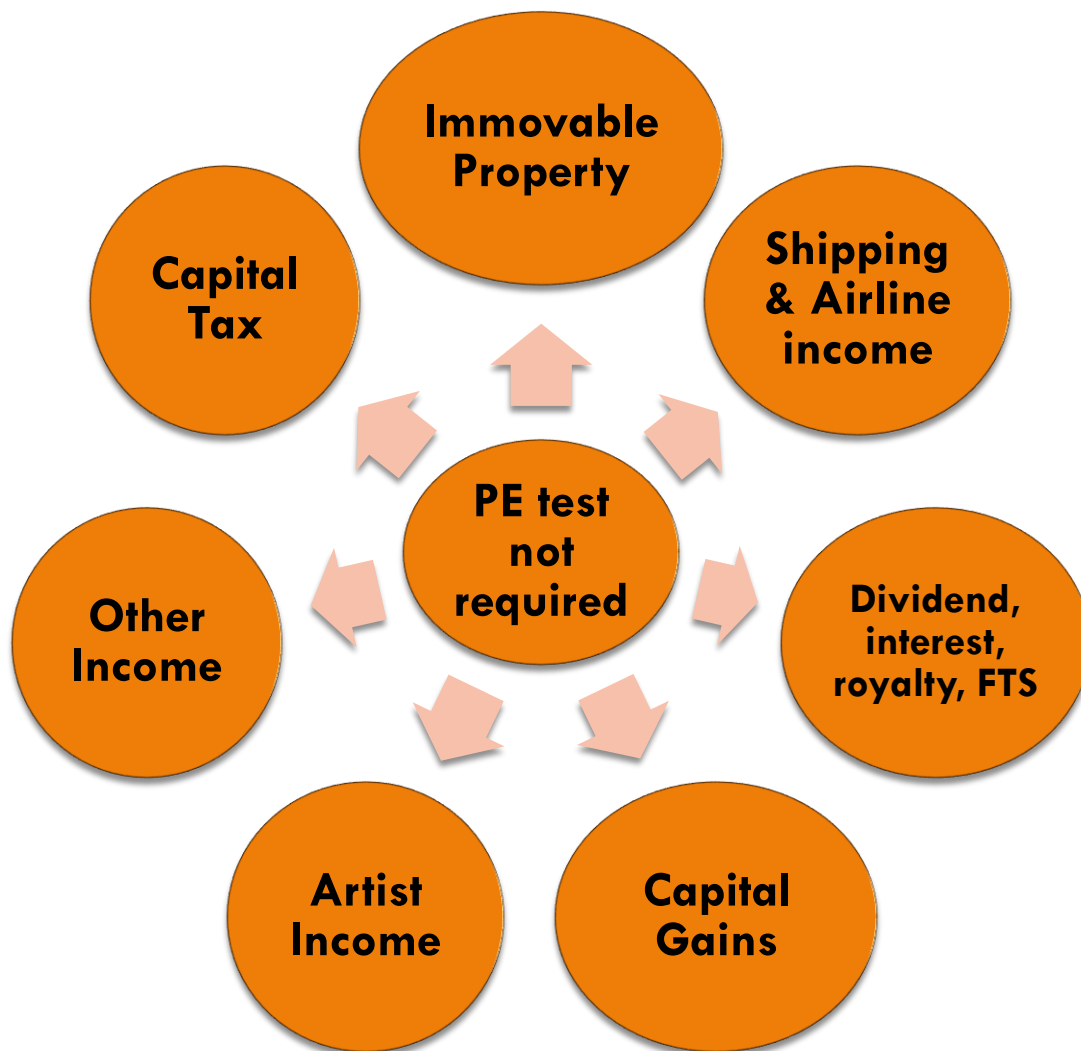
## □ When there is no treaty

In case India has not entered into any treaty with other country, the income of the non resident will be taxable in India if he has some business connection in India which also included an agent in India who satisfies condition laid down in explanation 2 to sec 9(1)(i) read with proviso 1 & 2.

However, so much profit shall be taxable in India which can reasonably be attributed to such operations.

# PE test is not required where income is taxable under following head.....

However, in case where there is a PE, some incomes are taxable under article 7 as business income.



## II. Royalty – Explanation 2 to sec 9(1)(vi)

### ▪ Consideration (including any lump sum consideration )for:

Transfer of all or any rights (including the license) in :

- Patent, invention, computer software, model, design, secret formula or process or trademark etc
- Copyright, literary, artistic or scientific work including films or video tapes/ tapes for use in TV/ radio broadcasting but not including consideration for the sale, distribution or exhibition of cinematographic films

Imparting of any information concerning:

- Technical, industrial, commercial or scientific knowledge, experience or skill.

Use of :

- Or right to use any industrial, computer software, commercial or scientific equipment.

### ▪Rendering of any service in connection with above

As per Tax Treaties, the Royalty is taxed in Country of Source (COS)

# Issue - Definition of 'Royalty' under Income Tax Act, 1961 vis-à-vis International Approach

- The benefit of more restricted definition of 'royalty' prescribed under the tax treaties can be claimed by a non-resident.
- However, India has expressed several reservations to the OECD commentary regarding definition of 'Royalty'

**Note: General contention raised by the Indian Tax Authorities is that the tax treaty provisions should be interpreted as per domestic law definitions.**

# Illustration of Characterization of income in case of E-commerce transactions

- ▣ Payments received from residents making online purchase of digital products such as podcasts, online subscriptions, shrink-wrap software, etc., could fall within the ambit of royalty, notwithstanding that they are merely a sale of a good in electronic form.
- ▣ Income derived from granting rights to use a copyrighted article, by way of an online copy of a book, could be characterized as royalty income in the hands of the recipient of income under the current domestic provisions.
- ▣ Updates and add-up to existing digital products/ software could also fall under the purview of 'royalty'.

**Note:** Issue of characterization of income earned from copyrighted copyright is yet not settled in a treaty situation. article versus a

## Issue - Definition of 'Royalty' under Income Tax Act, 1961 vis-à-vis International Approach

- ❑ The amended definition of 'Royalty' (*clarificatory amendment made by Finance Act 2012*) as provided under Income Tax Act, 1961, is wider than the definition accepted Internationally.
- ❑ The definition covers consideration received for license of computer software that does not involve the transfer of any underlying intellectual property.
- ❑ Whereas, as per Internationally accepted principles, it is treated like a simpliciter sale of copyrighted books.



## Issue - Definition of 'Royalty' under Income Tax Act, 1961 vis-à-vis International Approach

- 'Royalty' also includes payments for access to or use of scientific/technical equipment even if no control/possession is granted over the equipment (for instance, hosting website on third party servers without renting the server/obtaining any administrator rights over the server).
- Whereas, under internationally accepted principles, these payments can not be treated as royalty in the absence of transfer of control/possession over the equipment.

## Issue - Definition of 'Royalty' under Income Tax Act, 1961 vis-à-vis International Approach

- Under domestic law, payment of '**Royalty**' **between two non-residents is also considered to be sourced in India, if the payer utilizes the information, property or rights for a business or profession** carried out in India.
- ▣ *for instance, if a non-resident licenses any IP from another non-resident for onward licensing (either independently or in combination with other IP) to a resident in India, the payment made for the former license could be taxable in India, subject to relief provided under treaty.*

## Issue - Definition of 'Royalty' under Income Tax Act, 1961 vis-à-vis International Approach

### □ Embedded software

- The amendment made by F. Act, 2012 clarified that income generated by way of sale of embedded software would also be characterized as royalty income under the Income Tax Act.
- However, as per internationally accepted principles, the license of software is considered to be incidental to the sale of the product / hardware / device in which the software is embedded and therefore, any consideration received for such license of software is clubbed with the consideration for sale of the product / hardware / device.

# **III. Fee for technical services (FTS)**

## **□ Explanation to section 9(1)(vii)**

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".

**As per Tax Treaties, the FTS are taxed in Country of Source (COS)**



# CASE STUDIES

# Yahoo India (P.) Ltd. Vs. DCIT.

## [2011] 11 taxmann.com431(Mum.)

### **Facts:**

- a) Yahoo, HK provides internet services and marketing solutions on its HK portal such as banner, advertisement and microsite hosting services.
- b) Indian advertiser entered into contract with Yahoo India to approach Yahoo, HK for providing uploading and display of banner advertisement on Yahoo, HK portal.
- c) Yahoo India hired the services of Yahoo, HK for hosting banner advertisements and made payments without withholding any tax
- d) **Revenue Contention:** Payment for use of industrial commercial and scientific equipment taxable as royalty- tax should have been withheld.
- e) **Assessee's Contention:**
  - No possession or control over equipments (portal of Yahoo HK)
  - Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

## Contd....

- It was held by the Hon'ble ITAT that:
  - ▣ **Banner advertising hosting services did not involve use or right to use any industrial, commercial or scientific equipment.**
  - ▣ Yahoo, India had no right to access the portal of Yahoo, HK and nothing to show any positive act of utilisation or employment of the portal
  - ▣ Availing benefit/ taking advantage of an equipment cannot be construed as 'use' or 'right to use' of an equipment.
  - ▣ **Payment in the nature of business profit – not taxable in the absence of any PE of Yahoo, HK in India**
  - ▣ Relied on Delhi HC ruling of Asia Satellite telecomm. And AAR ruling in Dell International services & ISRO satellite centre

# People Interactive (India)

[I.T. Appeal Nos. 2179 to 2182 (Mum.) of 2009, dated 29-2-2012]

## □ Facts of the case:

- People Interactive, owner of matrimonial website
- Rackspare Inc., US provide following services:
  - Dedicated server and support team
  - Security of data stored on server
  - Bandwidth provision
- ***No tax was withheld*** on payments made by People Interactive for above services in the absence of Rackspare Inc.'s PE in India
- **Revenue's contention-** Payment for use of industrial commercial and scientific equipment taxable as royalty- tax should have been withheld
- **Assessee's contention-** Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India



## ITAT Decision

- People Interactive does not operate or have physical access to, or control of, the equipments
- All equipments and machines relating to the services provided under the control of Rackspare Inc. and situated outside India
- Not 'using' equipments but merely availing services by Rackspare- payment for such services ***not 'royalty'*** as per the India- USA DTAA and the Act (***judgment prior to the amendment***)
- Such payments not taxable as business profits as Rackspare Inc. ***does not have a PE in India***
- Relied on Delhi HC ruling in Asia Satellite Telecommunication Co. Ltd.

**Payment for website hosting not taxable as 'Royalty'**

# Pinstorm Technologies Pvt Ltd.

[2012] 24 taxmann.com 345 (Mumbai)

## Facts of the case:

- ❖ Pinstorm is engaged in business of digital advertising and internet, marketing; ***buy space on internet search engine***- Google, Yahoo, etc.
- ❖ Pinstorm ***books certain 'key words'*** on search engine; advertisements of Pinstorm or its clients are displayed when specific key word is searched on Google
- ❖ Google, Ireland renders online advertising services form Ireland; invoice and payment for such services made online
- ❖ ***No taxes withheld*** on payment to Google, Ireland for availing advertising services
- ❖ ***Revenue's contention***- services rendered by Google are in nature of 'technical service4' / royalty- tax should have been withheld
- ❖ ***Assessee's contention***- payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

## ITAT Decision

- ❖ Decision of Yahoo India followed
- ❖ Payment to Google, Ireland in the nature of business profits and not 'royalty'
- ❖ In the absence of PE of Google, Ireland in India, business profits not taxable in India

**Payment for uploading and display banner advertisement services not 'royalty'**

# EBay International AG

[2012] 25 taxmann.com 500 (ITAT-Mum.)

## Facts of the case

- E-Bay International AG, a Switzerland based company, provides platform for ***facilitating purchase & sale of goods and services to Indian Users***
- E- Bay AG received ***user free from sellers*** on successful completion of sale through its website- not offered to tax as Business profits, claiming no PE constituted in India
- Entered into marketing support agreement with E-Bay India and E-Bay Motors (group companies) for availing ***support services*** in connection with its India specific websites
- E- Bay India provided only marketing support services and was responsible for collection of user fees from sellers on behalf of the E-Bay AG
- ***Revenue's Contention-*** Income taxable in India as- services rendered in nature of ***managerial/ technical/ consultancy*** and taxable as per Indian DTA; group companies are in form of ***dependent agent PE***

## ITAT Decision

- Providing a platform for conducting business not managerial or consultancy services- ***no consultancy provided by E- Bay India at any stage***, either to the buyer or the seller.
- Such services not technical in nature- only involves ***provision of standard facility***
- E- Bay India ***not involved in finalization*** of transactions between buyers and sellers, does not maintain any stock of goods; or carry any processing of goods for E- Bay AG, hence not a DAPE under the Indian Switzerland DTAA- Business Profits not taxable in India
- Group Companies have ***no role*** in maintenance or operation of the websites and entering into online business agreements; hence do not form Place of management of E- Bay AG;'s India business

**User fee not taxable as FTS; Group companies do not constitute PE in India**

# Right Florists P. Ltd.

[2013] 32 taxmann.com 99 (Kolkata - Trib.)

## Facts of the case

- ❑ Assessee is a florist- uses advertising on search engines Google & Yahoo to generate business
- ❑ Makes *payment in respect of online advertising* to Google, Ireland and Yahoo, US
- ❑ *Does not include withhold taxes* from these payments and claimed deduction
- ❑ Server of Google and Ireland *located outside India*- they have no presence in India
- ❑ Advertisements services provided in a purely automated manner using algorithms and codes without human intervention
- ❑ *Revenue's contention*- Whether or not income was taxable in India, assessee should have approached the AO u/s 195 of the TDS
- ❑ *Assessee's contention*- Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

## ITAT Decision

- ❑ Payment made to Google and Yahoo for uploading and display of banner advertisement is business profit and not in the nature of 'royalty' – followed **Pinstorm**
- ❑ Search engine- present only through a website cannot be treated as PE under basic rule, **unless web servers are also located in India**- Business profits not taxable in India
- ❑ Online advertising services rendered by search engines completely **automated and without human intervention**- payments cannot be taxed as FTS under the Act
- ❑ Payments received by Yahoo, US not taxable as FTS under India- US DTAA since, advertising services **do not make available any technology**
- ❑ India' reservations on "website PE" in OECD Commentary were not relevant in judicial analysis
- ❑ A search engine having its presence only in the form of website cannot create PE, unless its web servers are also located in the relevant jurisdiction

**Payment for uploading and display banner ads. Services not 'royalty' and/ or 'FTS'**

# Verizon Communications, Singapore

[2013] 39 taxmann.com 70 (Madras)

## **Brief facts of the case:**

- ❖ Assessee company is engaged in the business of providing international connectivity services (bandwidth services or telecom services) to customers in India for transmission of data and voice;
- ❖ The assessee provided a dedicated private link to transport voice data and video traffic between the office in different Countries. Assessee provided international registration and VSNL provided local leg;
- ❖ Assessee used its equipment situated outside India for International leg
- ❖ The AO held that payment received by the assessee was taxable as 'royalty' for use of or right to use of commercial and scientific equipment under the Act and treaty
- ❖ ITAT confirmed AO's action and observed that as the agreement, the customer acquired significant, economic or possessory interest in the equipment of the assessee to the extent of the bandwidth hire by the customer. This was made available to the assessee on a dedicated basis. Thus, payments were for use of equipment as well as for the purpose.



## ❖ **Contention of the Assessee:**

- ❖ Service agreement- not royalty
- ❖ Customer does not get right to use equipment or attain any knowledge
- ❖ Relies on Sky cell, Asia Set and Dell International, Cable & Wireless, BSNL etc.

## ❖ **Hon'ble High Court Held that:-**

- ❖ Rejected that transactions only involve rendition of services
- ❖ Explanation 5 gives a very expansive meaning to Royalty. Thus, rendition of services through equipment (irrespective of use, control etc. ) were for royalties
- ❖ Payment is also for the use of “process” per Explanation 6, and is royalty as per treaty

## Observations made by Hon'ble High Court

“ In any event, in a virtual world, the physical presence of an entity has today become an significant one; the presence of the equipment of the assessee, its rights and the responsibilities of the assessee, vis-à-vis the customer and the customers' responsibilities clearly show the extent of the virtual presence of the assessee which operates through its equipment placed in the customer's premises through which the customer has access to data on the speed and delivery of the data and voice sent from one end to the other. The Explanations inserted thus clearly point out that the traditional concepts relating to the control, possession, location on economic activities and geographic rules of source of income recede to the background and are not of nay relevance in considering the question of dealing with issues arising on account of more complex situations brought in by technological developments by the use of and role of digital information, goods etc., the foreign enterprise does not need physical presence at all in a country for carrying on business. Hence, we don't think that we need to go in depth in this regard for the reason that we have already given herein before.”

## Key observation in Verizon...

- Services do not involve use or right to use of any industrial, commercial or scientific equipment
- No managerial, technical or consultancy services provided
- No right to access portal/ physical equipment of foreign company
- No PE of foreign company in India
- A search engine having its presence only in the form of website cannot create PE, unless its web servers are also located in the relevant jurisdiction
- Changes in 'royalty' clause in IT Act vis-à-vis tax treaty provisions?
- Virtual presence vis-à-vis physical presence.

# Other decisions.....

- **Reuters Transaction Services Ltd. V. DDIT(International Taxation) [2014] 47 taxmann.com 10 (Mumbai - Trib.)**
  - Where assessee, a non-resident company, allowed clients to use its software and computer system to have access to its portal for finding relevant information and matching their request for purchase and sale of foreign exchange, it amounted to imparting of information concerning technical, industrial, commercial or scientific equipment work and payment made in respect of same would constitute 'royalty' taxable in terms of article 13(3) of India-UK DTAA
- **Viacom 18 Media (P.) Ltd. V. ADIT (International Taxation) [2014] 44 taxmann.com 1 (Mum-Trib.)**
  - Payment of fees for use of satellite transponder service by assessee to US company taxable as 'royalty', under article 12 of India-US DTAA
- **ADIT v. Antwerp Diamond Bank NV Engineering Centre[2014] 44 taxmann.com 175 (Mumbai-Trib.)**
  - Belgium based bank, having obtained a licence to use software, allowed its Indian branch to use same software by making it accessible through server located at Belgium, amount reimbursed by branch on pro rata basis for use of said resources was not liable to tax in India as royalty under section 9(1)(vi) or article 12(3) of India-Belgium DTAA

# Issue- Data warehousing....

- Data warehousing involves the storage of computer data by the customers on servers owned and operated by the providers.

## **Standard Chartered Bank v. Dy. DIT (IT) [2011] 11 taxmann.com 105 (ITAT-Mum.)**

- There is no control or physical access to equipment used for data processing and it cannot be said that payment is made for use or right to use equipment. Assessee was a non-resident company carrying on business of banking in India through its various branches. It entered into an agreement with Singapore based company (S) for providing data processing support from outside India to be used for its business in India. Under agreement, S required to make available disc space capacity in its Singapore data centre for exclusive use by assessee.
- Amount payable by assessee to S is not 'Royalties' or 'Fees for technical services' within meaning of article 12 of Treaty
- Amount payable in nature of Business income and since S did not have any PE in India, same were not taxable in India as per article 7 of the DTAA
- **Therefore, amount payable by assessee as data processing charges to S was not liable to tax in India.**

## Case Studies on other issues

# Asia Satellite Tele Co Ltd. vs. DCIT

85 ITD 478 [2003] 85 ITD 478 (DELHI)

- Assessee, a non resident company, engaged in operating telecommunication satellites, under an agreement, leased out transponder capacity to TV channel companies and was broadcasting various programs in India via its satellite- Assessing officer held that since ultimate territory of commercial exploitation was in India, assessee was liable to pay tax on lease income u/s 9 (1)(i) – Commissioner (appeals) held that since said income was in nature of ‘royalty’, it was liable to taxed u/s 9(1)(vi)-
- Whether despite fact that assessee had business connection in India, viz., provisions of section 9(1)(i) were not applicable as no part of operations of assessee’s business was carried out in India- **Held, Yes**

- Whether since TV channel companies were utilizing services of assessee for earning income from advertisers and cable operations in India, by ultimately relaying programs in India territories, it could be said that lease rent earned by assessee arose from sources in India and as such fell within ambit of 'royalty' as contemplated u/s 9(1)(vi)(c )- **Held yes**



- Whether since TV channel companies were utilizing services of assessee for earning income from advertisers and cable operations in India, by ultimately relaying programs in India territories, it could be said that lease rent earned by assessee arose from sources in India and as such fell within ambit of 'royalty' as contemplated u/s 9(1)(vi)(c )- **Held yes**

## Other Judicial pronouncements....

- **B4U International Holdings Ltd. V. DCIT(IT) [2012] 21 taxmann.com 529 (Mum.)**
  - ▣ Payment by TV broadcaster, of hiring charges for transponder and charges for facilities in relation to reception and transmission of signals would not amount to FTS/Royalty.
- **DDIT(IT) v. Reliance Infocom Ltd [2013] 39 taxmann.com 140 (Mumbai-Trib.)**
  - ▣ Payment for use of copyright belonging to non-resident would amount to royalty within meaning of article 12(3) of DTAA

# Panamsat International System LLC-

103 TTJ 86 [2006] 9 SOT 100 (DELHI)

- Facts similar to Asia Sat's case (*as discussed*)
- As per article 12 of the DTAA entered between India and USA, inter alia includes “payment for any copyright... model, plan, secret formula or process, or...”
- The word “**process**” in the India US Tax Treaty qualified by “**secret**” and hence should be interpreted narrowly as compared to the Act; payment held not to be for any “secret process” but for a service/ facility; held not to be taxable as *royalty/ FIS*

# Issue- Bandwidth charges.....

- E-commerce business models involving the use of or access to different kinds of scientific / industrial equipment (for example, in case of bandwidth services, medical diagnosis, etc.), where no control / possession is granted to the service recipient, the domestic law definition of 'royalty' (as retroactively amended in 2012) is wide enough to cover payments thereof.
- However, Internationally, such payments are not construed as 'royalty' unless some element of control / possession is also granted over the equipment. Therefore, while interpreting tax treaties (*which override domestic law*), AAR has held in cases **Dell International Services India (P.) Ltd.** [2008] 172 Taxman 418 (AAR - New Delhi) that such payments do not constitute 'royalty'.

## Issue- Bandwidth charges.....



### Also See:

- **Software Technology Parks of India vs. ITO 3 SOT 529 (2005)**
- **Wipro Ltd vs. ITO 80 TTJ 191 (2005) 94 ITD 9 (Bang.)**

# Issue- Sale of Business Information Reports

- Taxability of payments for standardized “Business Information Report” publicly available on the Internet upon payment of subscription charges
- Such reports typically provide factual information about a company such as location, existence, operation, financial condition, pending litigation, etc along with rating of the company
- Emerging Judicial view:
  - Even though such reports are copyright protected, payments for purchase of such reports are akin to payments for copyrighted articles and not constituting “royalty”

***DUN & Bradstreet Espana S.A. 272 ITR 99 (AAR) and In re. ABC Ltd 284 ITR 1 (AAR)***

# Issue- Sale of 'Air-time'

## TVM Ltd. vs. CIT 237 ITR 230 (AAR) [1999] 102 TAXMAN 578 (AAR - New Delhi)

- ❑ TVM is a non resident company incorporated in Mauritius- TVI is an Indian Company. TVI is engaged in preparation and licensing of TV programs while TVM broadcasting, purchase these programs from TVI.
- ❑ TVM has entered in a separate solicitation agreement with TVI to solicit and collect advertisement in India on commission basis- TVM has no fixed place of business in India – TVM & TVI have same shareholder or group of shareholders with identical preparations of shareholding- Directors of TVM and TVI are, however different.
- ❑ As per article 7 of DTAA, TVM would be liable to tax in India only if it has PE in India.

- Whether for present, there being nothing to show that securing advertisement for programs developed by TVI is an ordinary incident of TVI's business, TVI cannot be considered to be an agent of TVM with independent status within meaning of clause (5) of article 5 of DTAA so as to say TVM has no P.E. in India?
- Whether even a non resident agent can be deemed to a P.E. only if he can act independently in matter of concluding contracts on behalf of principal on his own, freely and without control from principal and if such is situation in instant case, TVI would not constitute a P. E. for TVM- **Held, Yes**



- Whether, therefore, business profits earned by TVM through TVI are profits deemed to accrue or arise in India u/s 9 of the Income Tax Act, 1961 but the are not taxable in India by virtue of article 7 of DTAA provided
  - a. TVM's liability to pay tax in Mauritius is established; and
  - b. Only TVM and not TVI is shown to exercise generally power to conclude advertisement contracts for sale of air- time

# Cargo community Network Pte Ltd

289 ITR 355[2007] / 159 TAXMAN 243 (AAR - New Delhi)

- Applicant, a NR Co., has its registered office at Singapore- it is engaged in business of providing access to an internet based Air cargo Portal- An agent who books cargo through various airlines can subscribe for said portal, which, enables him to access data bank of airlines like flight schedules, availability of cargo etc.- For this service applicant charges subscription fee, system connects fee and help desk support fee, etc.- It is found that payments are made by cargo agent ('resident') in India for use of portal developed by applicant and hosted on his server in Singapore; portal is displayed on computer screen of cargo, and acceptance of connected airline is conveyed in India and, therefore, use of commercial equipment is made by Indian agent / subscriber to applicant for providing a password to access and use portal hosted from Singapore are in nature of royalties and fees for technical services and taxable under article 12 of DTAA as also u/s 9 and subject to deduction of tax at source- ***Held Yes***

# Issues...

- **ADIT, (International Taxation) 3(1), Mumbai v. Globus Stores (P.) Ltd [2012] 28 taxmann.com 117 (Mum.)**
  - ▣ The subscription made by garment manufacturer to online fashion website is royalty
  
- **CIT(IT) v. Wipro Ltd. [2011] 16 taxmann.com 275 (Karnataka)**
  - ▣ Payment made by assessee to a non-resident in order to obtain licence to use database maintained by it, is to be regarded as royalty

# **Kotak Mahindara Primus vs. Dy Dir of IT**

**(105 TTJ 578) [2007] 11 SOT 578 (Mumbai)**

- Assessee, a non-banking finance company, was jointly formed by an Indian company and an Australian Company – Assessee had made certain payment in consideration of its processing of data- No part of this payment can be said to be for the use of specialised software on which data is processed and for the use of mainframe computer because the Indian company does not have nay independent right to use the computer or even physical access to the mainframe computer, so as to use the mainframe computer or specialised software. The Indian company can feed the raw data in the mainframe computer in Australia, with the help of the telecommunication link, and output data, after due processing, is transmitted back to the Indian company. There is no privilege or right granted to the Indian Company by the Australian company. The control of the Indian company is only on the input transmission and the right is to get the output processed data back. The actual processing of data is in the exclusive control of the Australian company, and it is for this work that the Australian company gets paid.

- In our considered view, therefore, in essence the impugned payment is made to the Australian company in consideration of its processing of data belonging to the Indian company, Hence the same was not considered as Royalty. And as the Australian Company did not have a PE in India, Business Income was also not taxable.

# Othere pronouncements.....

- **GECF Asia Ltd. vs. DDIT (International Taxation), [2014] 48 taxmann.com 148 (Mumbai - Trib.)**
  - A non-resident company renders services relating to industrial, commercial or scientific experience, in such a case, if those services do not involve imparting of know-how or transfer of any knowledge, experience or skill, then payment received in respect of same cannot be taxed as "royalty" within ambit of article 12 of India-Thailand DTAA

# Concept of “Make Available”

- **Intertek Testing Services India (P.) Ltd., In re [2008] 307 ITR 418**  
Applicant is an Indian company engaged in business of general insurance- It entered into a service agreement with AXA ARC, a Singaporean company, which acts as a central service organizations and caters to requirements of AXA group of companies in region for receiving assistance such as business support, marketing, information technology support services and strategy support services, etc., so that it can carry on business in line with the best practices followed by other AXA group entities globally- Services are advisory in nature and by receiving such services applicant is not enabled to apply technology contained therein, i.e., technology, knowledge, skills, etc., possessed by service provider or technical plan developed by service provide- Under said agreement, AXA ARC will receive fee based on actual cost incurred plus a mark up of 5%- Whether, on facts, payment made by applicant to AXA ARC amount to ‘ fee for technical services’ and ‘royalty’ within meaning of article 12 of DTAA with Singapore- **Held, NO**

- *By making available the technical skills or know-how, the recipient of service will get equipped with that knowledge or expertise and be able to make use of it in future, independent of the service provider. In other words, to fit into the terminology 'make available' the technical knowledge, skills etc., must remain with the person receiving the services even after the particular contract comes to an end.*



# E-commerce under FDI Policy

# E-Commerce under Consolidated FDI Policy, 2014

- **“E-commerce activities refer to the activity of buying and selling by a company through the e-commerce platform”**
- Therefore, any buy/sale transactions would be covered except the other forms of transactions which could take place on e-commerce platforms such as information sharing and advance bookings (without payments being made).

# FDI regulations regarding foreign investments in E-commerce space in India

- 100% FDI is allowed under the automatic route (i.e. no FIPB approval is required) in companies engaged in B2B e-commerce.
- No FDI is allowed in companies which engage in single brand retail trading by means of e-commerce.
- No FDI is allowed in companies which engage in multi brand retail trading by means of e-commerce

**Note: above restrictions are related to sale of goods and not services.**

# FDI in B2C businesses.....

## **Model-1: Market place models**

- The online platform acts as a trading platform rather than a trader. In this case the online platform's clients are various sellers who own the inventory of goods and advertise their goods on the online platform. The ultimate sale of the goods is completed between the third party seller and the end consumer.

# Other Business Models.....

- ❑ Investing into companies engaged in wholesale trading (where 100% FDI is allowed under the automatic route subject to certain conditions) which owns inventory and maintains the online B2B platform
- ❑ Investing into companies providing technology services (where 100% FDI is allowed under the automatic route) which provides technology related services on an arms length basis to e-commerce platforms.

**Note: It is important that the Business models should be in compliance with the FDI Policy.**

# Other Important Issues related to E-Commerce Companies .....

- Need consideration
  - ▣ Categorization of income from certain e-commerce transactions under Income Tax Act vis-à-vis DTAA
  - ▣ Ownership of Intellectual Property Right (IPR)
  - ▣ Computation of Book profit under MAT provisions

# Thank You.....!!!

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