

## Tax Hotline

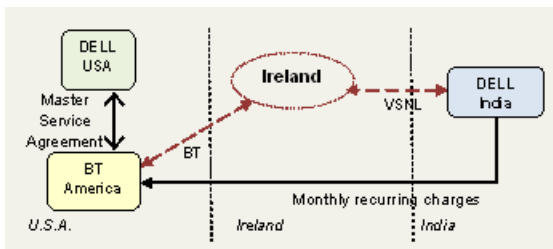
July 22, 2008

### PAYMENTS BY DELL FOR LEASED LINE CIRCUITS NOT TAXABLE IN INDIA

On July 18, 2008, the Authority for Advance Rulings ("AAR") pronounced, while considering the application of Dell International Services (India) Pvt. Ltd. ("Dell India"), that the payments made to a non-resident service provider for providing two-way transmission of voice and data through telecom bandwidth could not be considered as royalty payments or payments made for fees for included services and were hence not taxable in India.

Dell India is engaged in the business of providing call centre, data processing and information technology support services to its group companies. The parent company of the Dell India, Dell USA had entered into a Master Services Agreement with BT America ("BTA"), a company incorporated in USA, for provision of two-way transmission of voice and data through telecom bandwidth. Dell India has confirmed to the terms of the said agreement and makes recurring monthly payments to BTA pursuant to the same. While BTA provides the international half-circuit from the US and Ireland, the Indian half circuit is provided by an Indian telecom company, namely, VSNL with whom BTA has a tie-up.

#### Facts in Picture



#### QUESTIONS BEFORE THE AAR

The significant questions considered by the AAR are as follows:

- Whether the recurring charges paid to BTA would be considered as 'royalty' within the meaning of (i) Article 12(3) of the India-USA Double Tax Avoidance Agreement ("Treaty") or (ii) Explanation 2 to section 9(1) (vi) of the Income-tax Act, 1961 ("ITA")?
- Whether the recurring charges paid to BTA would be in the nature of "fees for included services" within the meaning of the term in Article 12 of the Treaty or "fees for technical services" under Explanation 2 to clause (vii) of section 9(1) of the ITA.

#### ANALYSIS

1. It was Dell India's contention that the agreement did not involve the use or right to use any equipment nor was any equipment installed for /kept at the disposal of Dell India. On the other hand, the Indian Income-tax Department ("Revenue") argued that the services were merely incidental to BTA granting Dell India the right to use or permitting the "use" of its point to point circuit and therefore, the consideration paid partakes the character of "royalty". The AAR considered the issue in detail, and held that the emphasis in the agreement was on service element and nowhere the use of equipment or the grant of rights for such use is contemplated. It was a rendition of service by BTA, using its own network and equipment. An important distinction was made between the expressions "use" and "right to use". The decision of the A.P. High Court in the case of Rashtriya Ispat Nigam Limited<sup>1</sup> was relied upon, which was subsequently also affirmed by the Supreme Court. It held that mere custody or possession of equipment without effective control can only result in use of the equipment whereas a right to use the equipment implies control over the equipment. The AAR compared the present transaction to using a road bridge or a telephone connection. Usage of equipment connotes that the grantee of right has possession and control over the equipment, but no part of the present arrangement could lead to such an inference. It was a plainly a case of BTA utilizing its own network and providing a service that enables Dell India to transmit voice and data through the media of telecom bandwidth. Further, there was also no question with respect to use of a secret process to qualify the payments as 'royalty'. Therefore, the payments made were held not to be in the nature of "royalty" payments.<sup>2</sup> As regards the question of the recurring charges being considered as 'fees for included services', the AAR held that the requirement in Article 12(4) of the Treaty that technical knowledge, experience, skill, etc. should be 'made available' so as to enable the

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recipient of the service to apply such technology, was not satisfied in the present case and thus, the payments cannot be considered as 'fees for included services'. Further, since Dell India gets the advantage of Treaty provision, the question of the applicability of the relevant provision of the ITA does not arise..

## OTHER ISSUES

Notwithstanding the above, the AAR also considered Dell India's contention that amounts paid by Dell India are for the purpose of making or earning any income from any source outside India and hence covered within the exception carved out in sections 9(1)(vii)(b) or 9(1)(vi)(b) of the ITA. Dell India claimed that its business principally comprises of export revenue, as it provides data processing and information technology support services to its group companies abroad. However, the AAR concluded that nothing precluded Dell India from making use of the facility for the purpose of its business in India, nor was any evidence produced before the AAR to support Dell India's contention.

The other questions put forth before the AAR were regarding the withholding tax liability of Dell India and whether BTA could be considered to have a permanent establishment in India. The AAR held that Dell India may approach the appropriate authority under the relevant provisions of the ITA to decide its withholding tax liability. The issue relating to the permanent establishment due to inadequate evidence was left open for determination in appropriate proceedings.

## CONCLUSION

In line with the various earlier judgments, the present AAR decision rightly differentiates between the consideration paid for use of equipment or for availing any service and concludes that unless Dell India is required to do a positive act of operation or control of the equipment in order to avail the facility, the payment under consideration cannot be considered a royalty payment for use of equipment. This decision removes ambiguities surrounding taxation of payments for leased lines particularly in the case of business process outsourcing units, especially call centers

*Advance rulings are generally available to non-residents and foreign companies for providing clarity with respect to their Indian tax liability in connection with transactions undertaken or proposed to be undertaken. These rulings are binding on the applicant and the revenue, but are not binding on others. However, they do carry persuasive value. Statutorily advance rulings are to be determined within 6 months.*

- Shreyas Jhaveri, Mansi Seth & Parul Jain

1 77 STC 182.

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