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TAX FLASH NEWS

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Payment for data transmission services through a transponder is not royalty under the India-Thailand and India-Netherlands tax treaties

Background

Recently, the Delhi High Court in the case of Shin Satellite Public Co. Ltd [1] (the taxpayer) held that payment for data transmission services through a transponder is not royalty under the India-Thailand and India-Netherlands tax treaties (tax treaties). A retrospective amendment introduced by the Finance Act, 2012 to the definition of 'royalty' will not affect Article 12 of the tax treaties. The High Court observed that no amendment to the Income-tax Act, 1961 (the Act), whether retrospective or prospective can be read in a manner so as to extend its operation to the terms of an international treaty.

Facts of the case

- Shin Satellite Public Co. Ltd. (taxpayer) is a company incorporated in Thailand, engaged in the business of providing digital broadcasting services as well as consultancy services to its customers who consist of both Indian residents and non-residents. The taxpayer provides these services through its satellite whose footprint covers a large geographical area, including India. New Skies Satellite B.V (taxpayer) is a company incorporated in Netherlands, engaged in providing digital broadcasting services. Both the taxpayers in the present case derive income from the 'lease of transponders' of their respective satellites.

- The taxpayers had filed nil returns for the relevant assessment years[2]. The Assessing Officer (AO) held that the income was taxable under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act) as well as under Article 12 of the India-Thailand/India-Netherlands tax treaties.

- The Tribunal relied on the decision of the Delhi High Court in the case of Asia Satellite Telecommunication Company Ltd.[3] where it was held that the receipts earned from providing data transmission services through the provision of space segment capacity on satellites do not constitute royalty within the meaning of Section 9(1)(vi) of the Act. Subsequently, the Finance Act, 2012 amended the definition of royalty under Section 9(1)(vi) of the Act retrospectively and inserted Explanation 4, 5, and 6. The inclusion of these explanations has attempted to undo the implications of the decision in the case of Asia Satellite Telecommunication Company Ltd.

[1] DIT v. Shin Satellite Public Co Ltd [ITA 500/2012], DIT v. New Skies Satellite BV [ITA 473/2012] (Del) – Taxsutra.com

[2] Shin Satellite – AY 2007-08 and 2009-10, New Skies – AY 2006-07 and 2008-09

[3] Asia Satellite Communications Co. Ltd. v. DIT [2011] 332 ITR 340 (Del)

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- The issue before the Delhi High Court was whether the income derived by the taxpayers through data transmission services was taxable as royalty under Section 9(1)(vi) of the Act as well as Article 12 of the tax treaties. Whether the amended definition of royalty under the Act can be used to interpret the definition of royalty in the tax treaties.

High Court's ruling

Taxability under the Act

- The legislature is competent to amend a provision that operates retrospectively or prospectively. Nonetheless, when disputes as to their applicability arise in court, it is the actual substance of the amendment that determines its ultimate operation and not the bare language in which such amendment is couched.

- The Delhi High Court in the case of TV Today Network Limited[4] held in favour of the tax department, and observed that as far as domestic taxability of the income from data transmission services is concerned, the Finance Act 2012 mandates it to be as such. Therefore, income from data transmission services is royalty.

- Explanations 4 to 6 are designed as clarificatory amendments. Unarguably they have all the apparent characteristics of one. The words 'for the removal of doubts, it is hereby clarified…includes and has always included' qualify the interpretation in Explanation 5. In Explanation 6, the same words have been modified, and they state 'includes and has always deemed to have always included'. This is the standard language used to communicate an intended retrospective effect.

- The circumstances in this case could very well go to show that the amendment was no more than an exercise in undoing an interpretation of the court which held income from data transmission services as non-taxable under Section 9(1)(vi) of the Act.

- The High Court is disinclined to conclusively determine or record a finding as to whether the amendment to Section 9(1)(vi) of the Act is indeed merely clarificatory as the tax department suggests it is, or prospective, given what its nature may truly be.

- The issue of taxability of the income of the taxpayer in this case may be resolved without redressal of the above question purely because the taxpayer had not pressed this line of arguments before the court and instead stated that even if it were to be assumed that the contention of the tax department is correct, the ultimate taxability of this income should rest on the interpretation of the terms of the tax treaties.

- The High Court, therefore, proceeds with the assumption that the amendment is retrospective, and the income is taxable under the Act.

Taxability under the tax treaty

- No amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend its operation to the terms of an international treaty.

- The clarificatory or declaratory amendment, which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment.

- Article 39 of the Vienna Convention on the Law of Treaties, 1969 (VCLT) states the general rule regarding the amendment of treaties and provides that a treaty may be amended by an agreement between the parties. Unilateral amendments to treaties are therefore categorically prohibited.

- As held in the case of Azadi Bachao Andolan[5], treaties are creations of a different process subject to negotiations by sovereign nations. The Madras High Court in the case of VR. S.R.M. Firms Ors[6] held that 'tax treaties are considered to be a mini legislation containing in themselves

[4] DIT v. TV Today Network Ltd [2014] 221 Taxman 123 (Del)

[5] UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)
[6] CIT v VR. S.R.M. Firms Ors [1994] 208 ITR 400 (Mad)

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all the relevant aspects or features which are at variance with the general taxation laws of the respective countries'.

- The Parliament is simply not equipped with the power to, through domestic law, change the terms of a treaty. A treaty is not drafted by the Parliament; it is an act of the executive.
- The decision in the case of Asia Satellite takes note of the OECD Commentary and Klaus Vogel on tax treaties, to show that the process must, in fact, be secret and that specifically, income from data transmission services do not partake of the nature of royalty.
- India's change in position to the OECD Commentary cannot influence the interpretation of the words defining royalty as they stand today. The only manner in which such change in position can be relevant is if such change is incorporated into the tax treaty itself and not otherwise.
- Mere amendment to Section 9(1)(vi) of the Act cannot result in change. It is imperative that such amendment is brought about in the tax treaty as well.
- Since the Finance Act, 2012 will not affect Article 12 of the tax treaties, it would follow that the first determinative interpretation given to the word 'royalty' in Asia Satellite, when the definitions were, in fact, *pari materia* (in the absence of any contouring explanations), will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a tax treaty, unless the said tax treaties are amended jointly by both parties to incorporate income from data transmission services as partaking of the nature of royalty, or amend the definition in a manner so that such income automatically becomes royalty.

Our comments

The issue with respect to taxability of payment for data transmission services through a transponder has been a matter of debate before the courts. The issue before the Delhi High Court was whether the retrospective amendment in Section 9(1)(vi) of the Act will also impact the tax treaty and the said payment would be taxable in India. The Delhi High Court held that payment for data transmission services through a transponder was not royalty under the India-Thailand and India-Netherlands tax treaties. A retrospective amendment introduced by the Finance Act, 2012 to the definition of royalty will not affect Article 12 of the tax treaties.

The High Court considered various decisions, Vienna Convention, etc. and observed that clarificatory or declaratory amendment, which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment.

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