



**Surana & Surana National Corporate Law
Moot Court Competition**
JSS Law College, Mysore
11 – 13 February 2011



BEFORE THE INCOME TAX APPELLATE TRIBUNAL, BANGALORE

SPECIAL BENCH

ITA No. 99/Blr/ 2010

Assessment Year: 2005 – 06

***ABC Advertising Limited, LLC,
Delaware***

Vs.

***The Commissioner of Income-tax (Appeals)
Company Circle, Bangalore***

Facts of the case:

1. The assessee is a company incorporated in the United States of America ('USA') according to the company laws of the State of Delaware. The assessee is having its registered office at Dover, the capital of Delaware, USA. The assessee is a wholly owned subsidiary of ABC Limited which is situated in Cayman Islands and incorporated according to the company laws of Cayman Islands. The assessee is mainly into the business of providing marketing and sales business, throughout the world, for its parent company i.e. ABC Limited, Cayman Islands.
2. The Cayman Islands entity provides telecommunication services to its various customers, spread across the world, through undersea cables and satellites which are owned by it.

Annexure 1: Modus operandi of transmitting communication signals through undersea cables

The servers are located at Cayman Islands owned by the ABC Limited, Cayman Islands. The entity owns servers with huge capacities and a separate point/ portal is provided to each of its customers. The point/ portal provided to each of the customers (telecasting companies) are not interpolated by other customers so that each customer enjoys exclusivity and a separate bandwidth is provided to each of them. The customers on the other hand, would install a server in their home country and would receive the communication signals transmitted from Cayman Island servers. The maintenance of the servers is all done by the Cayman Island entity. The customers' contract is only with the assessee and any complaint on interruption or weak signals would be placed only with the assessee and the assessee in turn would rectify the problem through its parent company, ABC Limited Cayman Islands.

Annexure 2: Modus operandi of transmitting communication signals through satellites

ABC Limited Cayman Islands owns several satellites located around 30,000 kms from the surface of the earth in space. The satellites have several transponders (the shields found on either side of the satellite) of which, each transponder is provided to each customer (telecasting companies) with a specific bandwidth to downlink the communication signals from earth. The customers on the other hand, own earth stations which would both uplink the raw communication signals to the satellite and then would receive the signals which is called downlinking. The main objective of availing the benefit of satellite is to cover maximum coverage (which is technically called foot print) for providing telecasting and telecommunication services to the ultimate customers of the telecasting companies.

The maintenance and management of satellites are similar to that of the servers and any complaint or rectification to be made would only be done by the Cayman Island entity and the telecasting companies do not maintain the equipments directly. However, once a particular transponder is provided to a customer by the assessee, the same is not interrupted or provided to another customer.

Role of the assessee in the above business transaction

3. The assessee is involved in marketing services and neither owns the satellites nor the undersea cables/servers through which the communication signals are transmitted. The assessee only identifies the customers and enters into agreement with them, as per the laws of United States both signed and executed in the U.S., to provide the telecommunication services. The right to provide telecommunication services by the assessee i.e. ABC Advertising Limited, LLC is by way of lease agreements or assignments that the assessee enters with its parent company situated in Cayman Islands. For providing the telecommunication services, the customers of assessee (telecasting companies) make payments to the assessee on yearly basis. The control of the satellite/ servers is done from outside India.
4. The assessee has several customers in India and provides telecommunication services vide above models. The assessee has a liaison office in Bangalore, India from which no effective operations occurred. The liaison office contains certain equipments and a small earth station only to monitor the effectiveness of the signals uplinked and downlinked by the telecasting companies (assessee's customers in India). The liaison office has recently filed its application with the Reserve Bank of India for closing down its operations and the same is under consideration. The liaison office has been compliant with all the Indian laws up to the date of its application for closure.
5. That apart, the assessee company filed its return of income under section 139(1) of the Income-tax Act, 1961 ('the Act') for the Assessment Year ('the AY') 2005-06 on 25th October, 2005 with NIL income with a view that the income earned in India is not taxable in India as it neither has a Permanent Establishment ('PE') as per India – US Double Taxation Avoidance Agreement ('DTAA or the treaty') nor a business connection as per section 9(1)(i) of the Act. The Income-tax Officer ('ITO'), Bangalore processed the return of the assessee and issued an intimation under section 143(1) of the Act on 24th October, 2006 raising a demand of INR 10,00,00,000. Further, the ITO selected the return of the assessee for scrutiny and served a notice under section 143(2)(ii) on 30th October 2006 asking for various details to be furnished. The assessee filed various documents and provided all the relevant information as sought by the ITO and claimed that its income is not taxable in India.
6. The ITO after considering all the submissions made by the assessee passed the assessment order under section 143(3) of the Act on 15th December, 2007 making a demand of INR 10,00,00,000 as per the intimation under section 143(1) on the following reasons:
 - i. The assessee is liable to pay income tax as the payments received by the assessee is 'royalty' as per Explanation 2 to section 9(1)(vi) of the Act and Article 12(3) of the treaty and therefore is liable to pay tax at the rate of 10 percent as per Article 12(2)(b) of the treaty (the turnover being INR 100,00,00,000);
 - ii. The assessee is liable to pay income tax as the payments received by the assessee is 'fees for included services' as per Explanation 2 to section 9(1)(vii) of the Act and Article 12(4) of the treaty and therefore is liable to pay tax at the rate of 10 percent as per Article 12(2)(b) of the treaty;
7. However, the ITO proceeded to tax the assessee's income as royalty income at the rate of 10 percent after giving it the benefit under the India – US tax treaty.
8. The assessee preferred an appeal before the Commissioner of Income-tax (Appeals) – VII, Bangalore ['CIT (A)'] on 13th January, 2008. The CIT(A) confirmed the order of the ITO stating that the income of the assessee is liable to tax as royalty income. Interestingly, the CIT(A) in its order made an observation that the income of the assessee could also be taxed as business profits as it had a permanent establishment as per the treaty and business connection as per the Act in India by way of its liaison

office and certain equipments. Further, he observed that the income of the assessee is attributable to the PE and be taxed as business income under section 28 of the Act. However, he did not proceed to enhance the tax assessed by the ITO and simply confirmed the order.

9. Aggrieved by the order of the CIT(A) the assessee has preferred the present appeal and has made all the necessary submissions. The department also has made a cross appeal on the point that the learned CIT(A) after having satisfied himself that the income of the assessee is also liable to be taxed as business income, he ought to have either remanded the matter to the ITO for assessing the income as business income or ought to have enhanced the assessment under his powers under section 251 of the Act. The tax department also strongly relies on the Assessment order and CIT(A) order in support of its case that the income of the assessee is liable to be taxed as royalty income under the treaty. Now the case has been posted for final hearing before the Hon'ble ITAT Special Bench.

The broad submissions made by the assessee before the ITAT:

1. The income received by the assessee is not liable to tax as royalty income as it does not fulfill the various requirements under the relevant sections and Articles of the Act and the treaty respectively such as there is no 'use' or 'right to use' of the servers or satellites by the customers of the assessee as they do not control or maintain the satellites or the servers. Further, there is no 'secret process' involved while transmitting the data.
2. The income received by the assessee is not liable to tax as fees for included services as it does not fulfill the various requirements under the relevant section and article of the Act and the treaty respectively.
3. The liaison office cannot be construed as a PE or a business connection as raked up by the CIT(A) as there were no activities being conducted from it. Therefore, the income of the assessee cannot be taxed at a higher rate as business income.
4. The assessee is not the actual owner of the servers/ undersea cables and the satellites and therefore cannot be construed as 'beneficial owner of the royalties or fees for included services' as per Article 12(2) of the treaty and therefore cannot be taxed under Article 12 of the treaty.
5. And such other arguments were placed by the assessee.

The broad submissions made by the department before the ITAT:

1. The assessee is liable to tax under the Act and the treaty as the income received by the assessee squarely falls under definition of 'royalty'.
2. The assessee is liable to tax under the Act and the treaty as the income received by the assessee is also liable to be taxed as 'fees for included services'.
3. After having observed that there is a PE in India by the CIT(A), the CIT(A) ought to have taxed the entire income of the assessee which is attributable to the PE as business income at the maximum applicable rates.
4. Since the payments are received by the assessee and since the agreements to render telecommunication services are entered between the assessee and the telecasting companies, the assessee is liable to tax in India as the source of income is from India.
5. And such other arguments were placed by the department.