Sum paid to facilitate Call Centers to communicate with USA customers held as 'royalty'

Summary – The Delhi ITAT in a recent case of Cincom System Inc., (the Assessee) held that where assessee US company provided Indian company a gateway that would facilitate communication from India to people of USA and vice versa and same was done through embedded secret software owned by assessee, payments received from Indian company was royalty

Facts

- The assessee Cincom-US was a US company and engaged in business of providing software solution. It entered into an agreement called communication agreement with Cincom India. It was agreed that the assessee-company would provide access to said company to internet and other e-mail and networking facilities along with other group concern.
- The assessee provided the access to Cincom-India to its internet by which it provided a gateway that would facilitate call centers to incoming and outgoing calls from India to the people of USA, referred as Cincom gateway. For this purpose assessee used embedded secret software owned by itself. In consideration of providing these services, the assessee-company was paid by the Indian company.
- For the assessment year 2002-03, the assessee-company offered tax as fees for included services. On appeal, the Commissioner (Appeals) held that the payment was not in the nature of fee for included services; however, he held that it was in the nature of royalty.
- For assessment years 2003-04 to 2006-07, the Assessing Officer held that the payments were in nature of royalty and brought the amount to tax. The Commissioner (Appeals) held that the payment was not in the nature of royalty.
- Being aggrieved by order of the Commissioner (Appeals), the assessee for assessment year 2002-03 and the revenue for assessment years 2003-04 to 2006-07 filed appeal before the Tribunal:

Held

- From the perusal of the agreement entered by the assessee-company with Cincom Systems (India) (P.) Ltd., it is clear that the assessee provided the access to its internet by which it provides a gateway that will facilitate call centers to incoming and outgoing calls from India to the people of USA, referred as Cincom Gateway. In other words, the assessee-company merely provided facility for a consideration. Then the question that comes up is whether the consideration paid for the use of such facility is in the nature of royalty as defined under the DTA between India and USA. Undisputedly, the impugned payment falls within the definition of 'royalty' as defined under the provisions of section 9(1)(vi). However, since the assessee-company is a resident of United States of America, it is entitled to be governed by the provisions of DTAA between India and USA, the term 'royalty' was defined in the article 12(3) of the DTAA.

- The nature of services provided by the assessee-company falls within the definition of 'royalty' as defined above. In the present case, it is a case of use of embedded secret software owned by the assessee-company for the purpose of enabling the customer from India to call the residents of USA or *vice-versa*.
- In the instant case, the concept of 'source' against 'residence' becomes more significant as the issue relates to cyberspace activities. The transmission of information is through encryption as the data relates to clients and strict confidentiality is observed. It is for the downloading of the software that the royalty is paid. In this context, the source rule becomes relevant which requires that royalty is sourced in the State of the payer. According to the agreement between the American Company and the Indian company, the facilities are to be accessed only by the Indian company. The consideration payable is for the specific programme through which the Indian company is able to cater to the needs of the group companies located in Japan and other places. The transaction would be related to a 'scientific work' and would partake of the character of intellectual property. The payments received in such transactions are for the use of intellectual property and partake of the character of royalty. The software is customized and secret. From the facilities provided by the American company to the Indian company, which are of the nature of online, analytical data procession, it would be clear that the payment is received as 'consideration for the use of, or the right to use design or model, plan, secret formula or process'. The use by the Indian company of the CPU and the consolidated data network of the American company is not merely 'use of or the right to use any industrial, commercial or scientific equipment' as envisaged in article 12(3)(b) of the DTAA but more than that. It is the use of embedded secret software (an encryption product) developed by the American company for the purpose of processing raw data transmitted by the Indian company, which would also clearly fall within the ambit of article 12(3)(a) of the DTAA between India and the USA.
- Article 12(b) of the DTAA between India and the USA provides that the main provision for taxation of royalties and fees for included (technical) services shall not apply if the beneficial owner of the royalties for fees for included services, being a resident of a contracting State carried on business in the other contracting State in which the royalties or fees for included services arise, through a PE situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such a case, the provisions of article 7 (Business Profits) or article 15 (Independent personal services), as the case may be, shall apply.