Case Study

An Israeli Telecom company

Service(s) Offered: **Tax Litigation**

Sector/Industry: **Telecom**

Tax litigation before the Mumbai Tax Tribunal

Our client, an Israel-based telecom company is engaged in the business of supplying software to various telecom businesses all over the world.

In order to provide product support services in India, our client had setup an Indian subsidiary in 2003. Given that the subsidiary was new, our client was assisting the subsidiary in rendering support services by lending necessary human resources and recovering only the cost and overheads.

We successfully defended the client's tax position of software payments not being taxable in India before the Mumbai Tax Tribunal for the Tax Years (TYs) 2003-04 and 2006-07. We were also successful in defending the tax position on non-taxability of payments made by the Indian subsidiary to our client for all the tax years till 2007-08.

However, from TY 2008-09 onwards, the Indian tax authorities came to a conclusion based on new facts and the ruling in the case of Reliance Infocomm that the payments for software supply will be considered as royalty payments.

Furthermore, the tax authorities also held that the Indian subsidiary was a Dependent Agent Permanent Establishment (PE) of our client. Alternatively, it was held that payment made by the subsidiary should be treated as technical service fee, if it is held that there is no PE.

Case Highlights

- Successfully proved to the Court that the client did not have a PE in India
- Argued that that payments received by the company were not taxable as FTS as it is reimbursement of expense
- Even if the payment is considered to be technical, it did not result in the transfer of knowledge to the recipient
- Obtained a favourable order from the Mumbai Tax Tribunal on all the grounds of the appeal

Our Solution

After detailed fact and legal research, we were able to counter every claim made by the Indian tax authorities.

At the Tribunal, we argued that the software sold was a standard copyrighted product. We also brought to the notice of the judges, by relying on several clauses of the agreement, that our client would remain the owner of intellectual property rights. Along with the Tax Counsel, we examined the additional software supply agreement to prove that the same was only for the supply of additional software, and the terms and conditions for the supply of software would remain the same as provided in the original agreement.

We were successful in convincing the judges that although the agreement mentions the source code and signing an escrow agreement, no escrow agreement was signed and neither the source code was transferred.

We also argued that since the term ‘computer software’ is not used in the India-Israel Tax Treaty, there is no intention to cover software payments. We also highlighted various other tax treaties (like Namibia and Russia) where computer software is specifically covered under the treaty. We were in a position to argue that there was no change in the facts from earlier years, and hence the order’s of earlier years should be followed.

On the issue of services provided by the company to the Indian subsidiary, the tax officer contended that the Indian subsidiary acted on behalf of the company in India. The Indian subsidiary is completely dependent on the company to earn its revenue in India. Accordingly, the tax officer concluded that Indian subsidiary should be considered as Dependent Agent PE of the company.

We argued that the Indian subsidiary is an independent entity earning income in India. It was also demonstrated that the agreements entered by the Indian subsidiary was on a principal-to-principal basis.

Furthermore, in earlier years, the Indian tax authorities had not raised an issue regarding a PE, and hence the said argument cannot be taken in 6th year of the transaction (i.e. principle of consistency should be followed). Furthermore, it was also argued that none of the conditions of a Dependent Agent PE were discussed by the tax officer in its order. Based on these arguments, we were able to convince the judges that there is no PE in India.

The tax authorities had also done a protective assessment, wherein if it was held that a company does not have a PE in India, then the payments received for rendition of services was taxable as Fees for Technical Services (FTS) as it made available technical, knowledge, skills, etc. to its Indian subsidiary.

Before the Tribunal, it was argued that payments received by the company were on a cost-to-cost basis without any income element and hence not taxable in India at all as it is reimbursement of expense.

As an alternative argument, it was argued that even where payments are considered to be technical in nature, the same should not be taxable in India as it did not result in the transfer of knowledge to the recipient of the services according to the India-Canada Double Tax Avoidance Agreement (DTAA) read with protocol to the India-Israel DTAA.

It was bought to the notice of judges that the India-Israel DTAA does not provide for the ‘make available’ clause in the agreement. We took the help of the protocol and the most favoured nation clause, and took support of the India-Canada DTAA to bring out the make-available clause. We also relied on earlier year orders and other judicial precedents to strengthen the case.

Impact

We were in a position to obtain a favourable order from the Mumbai Tax Tribunal on all the grounds of the appeal. This ruling will have a far-reaching impact on all the subsequent years as the same would become a binding precedent. This will result in substantial tax savings for the client on a yearly basis.