India; Belgium

Payment for Interconnectivity, Acquiring Capacity by Vodafone India to Non-residents Not Royalty, No WHT Liability, Says Indian High Court

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The Karnataka High Court (HC), in the case of *Vodafone Idea Ltd. v. Deputy Director of Income Tax & Ors* (ITA. No 160/2015), held that payments made to non-resident entities for providing interconnectivity services and transfer of capacity cannot be considered as royalty under the pre-amended provisions of Indian law. Consequently, the payments were not taxable in India and the taxpayer was not in default for non-deduction of withholding tax (WHT).

(a) Facts. The taxpayer company, a tax resident of India, holds an international long-distance (ILD) license and provides connectivity to calls originating from/terminating outside India. The taxpayer executed contracts with:

- non-resident telecom operators (NTOs) for international carriage and connectivity services and paid inter-connectivity charges to NTOs without deduction of WHT under section 195 of the Income Tax Act, 1961 (the Act);
- a Belgium company for the transfer of capacity/bandwidth on payment of consideration without deduction of WHT.

The tax authorities considered that such payments (for multiple tax years) were royalties or fees for technical services (FTS) under the amended provisions of section 9(1)(vi) of the Act and that the taxpayer defaulted in making payments to the non-resident entities without WHT deduction under the Act.

(b) Issue. The HC considered the issue of whether the tax authorities were correct in holding that payments made by the taxpayer were chargeable to tax as royalties under the amended provisions of section 9(1)(vi) and consequently, whether the taxpayer was bound to deduct WHT on such payments.

(c) Decision. The HC ruled in favour of the taxpayer as specified above. The observations of the HC are set out below:

- The equipment and the submarine cables were situated overseas. To provide ILD calls, the taxpayer had availed certain services from NTOs.
- The Belgium entity did not have any "permanent establishment" in India. Thus, the tax authorities in India have no jurisdiction to bring to tax the income arising from an extra-territorial source.
- Section 9(1)(vi) was amended by Finance Act, 2012 expanding the definition of royalty, while the payments were made during the tax years 2008-09 to 2012-13. The HC relied on the Supreme Court's decision in *Engineering Analysis* to the effect that such amendments were clarificatory and could not be applied for the relevant tax years. Thus, the taxpayer cannot be held to be in default for the non-deduction of WHT for the relevant tax years when the amended provisions did not exist in the law.
- For subsequent years, in the taxpayer's own case, the lower court held that tax is not deductible when payment is made to a non-resident telecom operator.
- A tax treaty is a sovereign document between two countries. The taxpayer is entitled to take the benefit under a treaty. Hence, the tax authorities' view that a tax treaty cannot be considered while determining WHT liability is not tenable.

This decision was pronounced by the Karnataka High Court on 14 July 2023.
