

Payment to telecom operators towards connectivity charges without right to use ‘equipment’ or ‘process’ is not taxable as royalty; retrospective amendment cannot fix liability to withhold tax on past payments

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In brief

Recently, the Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) held the following in the case of an Indian bulk SMS service provider¹:

- The payment for standard connectivity charges could not be considered as ‘royalty’, as the deductor had neither any access/ control over the equipment nor was there any usage of any process/ equipment, which could be said to have been made available to the deductor.
- A deductor could not be held liable for withholding tax on past payments in view of retrospective amendment, as the law could not compel a person to perform the impossible.

In detail

Facts

- The deductor was a company engaged in the business of providing mobile message services and operating SMS messaging platform to enable users to create mobile communities and broadcast bulk messages to such communities.
- The deductor engaged a telecom operator (an Indian company) to send bulk messages and made

payment in the nature of short message peer to peer (SMPP) connectivity charges to such telecom operator.

- The telecom operator created customer’s account and provided IP addresses, username and password to the deductor. The deductor then integrated such details in its system for transmitting bulk messages to the telecom operator without any access or control over the SMPP

connectivity facility, telecom operator’s server or network.

- The deductor withheld tax under section 194C of the Income-tax Act, 1961 (the Act) while making payment of SMPP connectivity charges to the telecom operator, treating the arrangement as a works contract.
- The tax authorities, while issuing certificate under section 197 of the Act to the telecom operator, treated the payment for SMPP

¹ ITA No. 848/ Mum/ 2015 and ITA No. 850/ Mum/ 2015

connectivity charges liable to withholding tax under section 194C of the Act².

- The tax officer (TO) held that the payment for SMPP connectivity charges was 'royalty' as defined under section 9(1)(vi) of the Act, and that tax should have been withheld under section 194J instead of 194C of the Act. Accordingly, the TO held the deductor to be a taxpayer in default under section 201(1) of the Act, and raised demand on account of tax and interest.
- The Commissioner of Income-tax (Appeals) [CIT (A)] confirmed the TO's stand. The CIT(A) held that transmission of bulk SMS was through a 'process', which was covered within the category and ambit of definition of royalty as provided in section 9(1)(vi) of the Act, specifically in light of the retrospective amendment brought by Finance Act, 2012.³
- Aggrieved, the deductor filed an appeal before the Tribunal.

Issues before the Tribunal

Did the payment for SMPP connectivity charges made by the deductor to the telecom operator constitute 'royalty'.

Deductor's contentions

- The payment for connectivity charges had not been made for 'usage of any equipment'. Neither any equipment nor any kind of technology could be said to have been passed on from the telecom operator to the deductor. No proprietary information or process had been passed on to the deductor.

- Placing reliance on decisions of the Delhi High Court,⁴ the deductor contended that for a payment to be characterised as royalty for use of equipment, in fact, the equipment must be used for rendering the service.
- In the deductor's regular assessment proceedings, no disallowance had been made under section 40(a)(ia) of the Act for non-deduction of taxes under section 194J of the Act.
- The deductor was providing similar services to the Income-tax Department, which itself had withheld tax under section 194C of the Act while making payment to the deductor. Therefore, a different yardstick could not be applied *qua* the same payment made by the deductor to the telecom operator.

Revenue's contentions

- The Revenue strongly relied upon the retrospective amendment to the definition of royalty in Explanation 2 read with Explanation 6 to section 9(1)(vi) of the Act.
- The payment made by the deductor was for use of equipment/ process of the telecom operator, and therefore, was covered within the definition of 'royalty'.

Tribunal's ruling

- The payment for standard connectivity charges could not be considered as 'royalty', as the deductor neither had any access/ control over the equipment nor was there any use of any process/ equipment that could be said to have been made available to the deductor. Further, the concept of 'use' or

'right to use' any equipment alludes to the concept of leasing, which was admittedly not there in this case.

- The agreement between the deductor and the telecom operator was in the nature of a works contract, for which the deductor had rightly withheld tax under section 194C of the Act.
- The Tribunal, relying on a coordinate bench ruling,⁵ emphasised the legal maxim '*lex non cogit ad impossibilia*' that is, the law cannot compel a person to perform the impossible. Accordingly, a deductor could not be held liable for not withholding tax on past payments in view of retrospective amendment, brought from a later date.

The takeaways

This decision is welcome since it has analysed the definition of the 'royalty' under the provisions of the Act and has concluded that the payments of connectivity charges to telecom operations would be subject to deduction of tax under section 194C of the Act. The Tribunal has emphasised the aspect of actual use of 'equipment' or right to use the 'process' to render the payment as royalty. Further, the ruling has reiterated that the deductors cannot be compelled to withhold tax in view of retrospective amendments brought from a subsequent date.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

² Although a certificate had been issued to the telecom operator under section 197 of the Act; however, this fact has not been discussed by the Tribunal while pronouncing the order.

³ Explanation 6 to section 9(1)(vi) of the Act inserted by Finance Act, 2012 w.r.e.f.

June 1, 1976 provides that "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar

technology, whether or not such process is secret.

⁴ Writ petition no. 7416 of 2012 and 332 ITR 340

⁵ 139 ITD 49 (2012)

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