#2 to 9

% 30.09.2011

Present: Ms. Rashmi Chopra, Advocate for Mr. Sanjeev Sabharwal, Advocate for the Petitioner.
Mr. Mayank Nagi with Ms. Mahua Kalra, Advocate for the Respondent.

(Common order)

\+ **ITA 1122/2011**
ITA 1123/2011
ITA 1124/2011
ITA 1125/2011
ITA 1126/2011
ITA 1127/2011
ITR 1128/2011
ITA 1129/2011

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Learned counsel for the Revenue submits that the issue is directly cover by the judgment of this Court in the case of ***Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax in ITA 131/2003*** decided on 31.01.2011. Following that judgment these Appeals are also dismissed.

A.K. SIKRI, J.

SIDDHARTH MRIDUL, J.

SEPTEMBER 30, 2011
hk

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.131 of 2003**
with
ITA No.134 of 2003

Reserved On: July 07, 2010
% Pronounced On: JANUARY 31, 2011

1) **ITA No.131 of 2003 & CM No.2865/2009**

ASIA SATELLITE TELECOMMUNICATIONS CO. LTD.
. . . Appellant

through : Mr. S. Ganesh, Sr. Advocate with Ms. Anuradha Dutt, Ms. Vijayalakshim Menon, Ms. Ekta Kapil, Mr. Anish Kapur, Mr. Kuber Dewan and Ms. Vrinda Tulshan, Advocates

VERSUS

DIRECTOR OF INCOME TAX . . .Respondent

through: Mr. Sanjeev Sabharwal, Advocate

2) **ITA No.134 of 2003**

DIRECTOR OF INCOME TAX . . .Respondent

through: Mr. Sanjeev Sabharwal, Advocate

VERSUS

ASIA SATELLITE TELECOMMUNICATIONS CO. LTD.
. . . Appellant

through : Mr. S. Ganesh, Sr. Advocate with Ms. Anuradha Dutta, Ms. Vijayalakshim Menon, Ms. Ekta Kapil, Mr. Anish Kapur, Mr. Kuber Dewan and Ms. Vrinda Tulshan, Advocates

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. Both these appeals, one preferred by the Revenue and other by the assessee, arise out of same judgment of the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal'). In fact, as noted hereafter at the appropriate stage, some of the issues are decided by the Tribunal in favour of the assessee and some other issues against the assessee and in favour of the Revenue. It is for this reason that both feel aggrieved by some of the findings of the Tribunal and have approached this Court in the form of these appeals preferred under Section 260A of the Income Tax Act (hereinafter referred to as 'the Act'). ITA No.131 of 2003 filed by the assessee was admitted on the following substantial questions of law:

> "(i) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the amounts received by the Appellant (a non-resident) from its non-resident customers for availing transponder capacity was chargeable to tax in India where the satellite was not stationed over Indian airspace and in directing how much income is to be determined?
>
> (ii) Whether on the facts and in the circumstances of the case Tribunal was right in holding that the Appellant had a business connection in India through or from which it earned income?
>
> (iii) Whether on the facts and in the circumstances of the case the Tribunal was justified in holding that the amount paid to the Appellant by its customers represented income by way of royalty as the said expression is defined in Explanation 2 to Section 9(1)(vi) of the Income Tax Act?
>
> (iv) Whether on the facts and in the circumstances of the case the Tribunal was justified in holding that the customers of the Appellant were either carrying on business in India or had a source of income in India and, hence, the amount received by the Appellant from its customers were chargeable to tax in India?

(v) Whether on the facts and in the circumstances of the case the Tribunal was justified in admitting the additional ground raised by the revenue seeking to assess the amounts received by the Appellant as fees for technical services in terms of Section 9(1)(vii)?

(vi) Whether on the facts and in the circumstances of the case the Tribunal was justified in directing the Assessing Officer to allow the expenditure relatable to India only whilst computing the income chargeable to tax in India?

(vii) Whether on the facts and in the circumstances of the case the Tribunal erred in holding that depreciation was admissible to the appellant only on a proportionate basis?"

2. Likewise, in ITA 134 of 2003, the following substantial questions of law were framed for determination:

"(i) Whether the ITAT is right in law in holding that the interest under Section 234B of the Income Tax Act, 1961 should be calculated by giving benefit to the assessee of tax deductible under Section 195 by the payer though no such deduction in fact was made?

(ii) Whether Ld. ITAT is right in law in holding that sec.9(1)(i) of the Income Tax Act, 1961 is not applicable in the case of the assessee?

(iii) Whether the Ld. ITAT has erred in not deciding the issue whether income of the assessee is taxable u/s 9(1)(vii) of the Income Tax Act, 1961?

(iv) Whether ITAT is right in holding that transponders cannot be regarded as equipment under Explanation 2 clause (iva) to section 9(1)(vi) of the Income Tax Act, 1961?"

3. Though both the parties have preferred appeals and are therefore, they are appellants in their respective appeal. For the sake of convenience, M/s. Asia Satellite would be referred to as the appellant and the Director, Income Tax is referred to as the Revenue, hereinafter.

4. A glimpse of questions of law enumerated above gives a fair idea of the contours and the nature of dispute involved. However, it would still be necessary to highlight the factual premises under

which the dispute has arisen. This job can be accomplished b taking stock of the factual matrix of ITA No.131 of 2003, as the similar scenario prevails in the other appeal as well.

Re: Statement of Facts:

5. The appellant/assessee, viz., Asia Satellite Telecommunications Co. Ltd., is a company incorporated in Hong Kong and carries on business of private satellite communications and broadcasting facilities. This company was formed in 1988 and it claims that it had no office in India. Appeal pertains to the assessment year 1997-98 and it is also claimed that during the relevant previous assessment year, i.e., 1996-97, the assessee had no customers, who are residents of India. During the previous year, relevant to the assessment year under appeal, the appellant was the lessee of a satellite called AsiaSat 1 which was launched in April 1990 and was the owner of a satellite called AsiaSat 2 which was launched in November 1995. These satellites were launched by the appellant and were placed in a geostationary orbit in orbital slots, which initially were allotted by the International Telecommunication Union to UK, and subsequently handed over the China. These satellites neither use Indian orbital slots nor are they positioned over Indian airspace. The footprints of AsiaSat 1 and AsiaSat 2 extend over four continents, viz., Asia, Australia, Eastern Europe and Northern Africa. The footprint is that area of the earth's surface over which a signal relayed from the appellant's satellite can be received. AsiaSat 1 comprises of a South Beam and a North Beam and AsiaSat 2 comprises of the C

Band and the Ku Band. The territory of India falls within th footprint of the South Beam of AsiaSat 1 and the C Band of AsiaSat 2.

6. It enters into an agreement with TV channels, communication companies or other companies who desire to utilize the transponder capacity available on the appellant's satellite to relay their signals. The customers have their own relaying facilities, which are not situated in India. From these facilities, the signals are beamed in space where they are received by a transponder located in the appellant's satellite. The transponder receives the signals and on account of the distance the signals have travelled, they are required to be amplified. The amplification is a simple electrical operation. Thereafter, the frequency on which the signals are to be downlinked is changed only in order to facilitate the transmission of signals so that there is no distortion between the signals that are being received and the signals that are being relayed from the transponder. The transponder operations are commonly known, which are carried out not only in satellite transmission but also in the case of terrestrial transmission. There is no change in the content of the signals whatsoever that is carried out by the appellant in the transponder. Thereafter, the signals leave the transponder and are relayed over the entire footprint area where they can be received by the facilities of the appellant's customers or their customers.

7. It is the case of the assessee that it has no role whatsoever to play either in the uplinking activity or in the receiving activity. Its role is confined in space where the transponder which it makes

available to its customers performs a function which it is designe to perform. The only activity that is performed by the appellant on earth is the telemetry, tracking and control of the satellite. This is carried out from a control centre at Hong Kong.

8. For this reason, it is claimed by the appellant that no part of the income generated by it from the customers to whom the aforesaid services are provided was chargeable to tax in India and for this reason no return income was filed in India. However, Deputy Commissioner of Income Tax (Non-resident Circle), New Delhi as Assessing Officer issued a letter notice dated20.10.1999 under Section 142(1) stating that the assessee had entered into agreements with various companies for lease of transponders for downlinking programmes to various countries including India and therefore, income of the assessee was chargeable in India. The appellant was accordingly called upon to file its return. The assessee responded by questioning the authority of the AO and explaining as to why its income was not chargeable to tax in India. It also sought some time to file its return of income. Ultimately, the return was filed on 30.12.1999, reiterating that no income earned by the appellant was chargeable to tax in India.

9. The AO, however, went ahead with the assessment proceedings. The assessment order dated 29.03.2000 was passed assessing the income of the assessee at ₹160,28,03,316. According to the AO, the appellant had a business connection in India and, therefore, was chargeable to tax in India. He rejected the appellant's contention that its revenues ought to be apportioned having regard to the number of countries covered by the footprint.

According to him, the revenues would have to be apportioned o the basis of countries targeted by the T.V. Channels who were the appellant's customers. On this basis, he estimated that ninety percent of the appellant's revenue was attributable to India. After arriving at the income of the appellant, he held that eighty per cent thereof was apportioned to India as most of the channels were India specific and their advertisement revenue was from India.

Order of the CIT(A)

10. Being aggrieved by the order of the AO, the appellant preferred an appeal to the CIT (A). Various grounds were urged challenging the liability to pay tax in India as well as the manner in which the AO had computed the appellant's income chargeable to tax.

11. The CIT (A) disposed of the appeal by an order dated 04.12.2000. He noted that there was no dispute that the appellant had not received any income in India. The only dispute, according to the CITA (A), was as to whether any income could be deemed to have accrued to the appellant in India within the meaning of Section 9 of the Act. He held that although it could be said that there was some kind of territorial nexus of the beam which was downlinked from the appellant's satellite with India, the proprietary rights in the nature of copyright, etc. in the down linked beam did not belong to the appellant but belonged to the T.V. channels. He held that there was no evidence on record to hold that the appellant had any India specific beaming facility. He found that on the basis of the facts brought on record it could not be said that

the down linked beam could be restricted to any particular regio or country. According to the CIT (A), it was the responsibility of the appellant to keep the equipment in good shape and to ensure the quality of the down linked beam in the footprint area in respect of a beam uplinked by the customer. He found that the telemetry, tracking and control operations were carried out from Hong Kong and that no beam was uplinked from India. His finding was that the agreements were signed outside India and the payments were also received outside India. Only the signals could be received in India but as a matter of fact these were not received in India either by the appellant or its agent but by cable TV operators who had agreements for reception of signals with the TV channels to whom the property in the signal belonged. He accordingly held that as the performance of the contract was not in India it could not be said that any income accrued to the appellant in India. He found that the circular, being Circular No.742 dated 2nd May, 1996, issued by the Central Board of Direct Taxes in connection with the taxation of foreign telecasting companies would have no application to the appellant's case. He rejected the argument of the AO that the waves generated by the appellant on which the programmes were mounted penetrating Indian space to reach the footprint area. According to him, the substance of the agreement was the hiring of transponder time and it was not an agreement for carrying programmes of the customers. He further held that having regard to the judgment of the Supreme Court in the case of ***20th Century Finance Corporation and Anr.*** Vs. ***State of Maharashtra*** **[119 STC**

182], the taxable event would have to be decided on the basis c the execution of the contract and as admittedly the contracts were entered into outside India the accrual of income would also take place outside India.

12. Thereafter, the CIT (A) dealt with the issue as to whether the appellant would have a business connection in India. After referring to certain decisions of the Supreme Court, he concluded that the appellant did not have any agreement with any Indian company and was not rendering any service to any Indian company and, therefore, it could not be said that the appellant had a business connection in India. He also held that the appellant was not carrying out any operations in India as the only operations that were carried out by the appellant were in the satellite which was located outside India. The mere fact that the appellant had put in place a satellite in a manner that downlinked signals could be received in Indian territory also did not result in an inference that any part of the appellant's business operations were carried out in India. As per him, the position may have been different if it had been shown that the satellite company, the TV channels and the cable operators were interconnected or that the transactions among them were not carried out at arms length. But as there was no evidence or mention of any of these factors, he held that no income could be said to be deemed to accrue or arise in India in terms of Section 9(1)(i).

13. CIT (A) thereafter proceeded to deal with the issue as to whether the amounts received by the appellant were liable to be taxed in India in terms of Section 9(1)(vi) of the Act. Argument of the

Revenue in this behalf was that the appellant received payment from some companies located outside India which companies in turn received payments from Indian companies or companies operating in India in respect of signals received in India and, therefore, the provisions of Section 9(1)(vi) would be attracted. According to the AO, the appellant would fall within the definition of royalty as the said term was defined in Explanation 2 below Section 9(1)(vi), as it was a payment for use of "similar property". The CIT(A) held that the issue to be decided was whether the customers were merely using a physical asset or were they using the process installed in the transponder. According to him, the signals were uplinked by the customers and were received in the transponder. The complicated devices in the transponder segregated the programme from the beam, amplified them, mounted them on new beams of wavelengths different from the original wavelength of the customers and transmitted the programmes on the new beam in the footprint area of the beam. The payments that are made by the customers were for this purpose and not for the use of the physical asset simpliciter. The details of the operations carried in the transponder were not known to the customer, the customer made the payment because they were aware of the fact that the uplinked beam would be processed in the satellite and would be downlinked in the manner that it could be received by the customers viz., the TV channels, communication companies or their agents. The CIT (A) held that the customers were, therefore, using the secret process put in place in the transponder on the satellite and the payments were

made for this purpose and not for merely the use of a physica asset. He, therefore, came to the conclusion that the amount paid to the appellant by its customers represented royalty as the said expression was defined in Explanation 2 below Section 9(1)(vi). He further held that in view of the judgment of the Supreme Court in the case of ***Performing Rights Society*** Vs. ***Commissioner of Income Tax*** **[106 ITR 11)**, it would be apparent that the TV channels would be making the payment by way of royalty in respect of a right or information used or services utilized for the purpose of a business carried on by them in India. The TV channels which made programmes predominantly meant for Indian persons were utilizing the processing facilities of the appellant for the business carried on by them in India and hence the appellant was chargeable to tax in India.

14. Having regard to the view that he took, viz., that the income was chargeable to tax in terms of Section 9 (1) (vi), he felt that it was not necessary to consider the question of deductibility of the expenses. Nevertheless, he thought it fit to dispose of all the grounds that were raised and were filed before him. Insofar as the claim for lease rentals is concerned, he held that 50% of the lease rentals payable for AsiaSat 1 ought to be allowed as a deduction. Similarly, the expenditure on maintenance and satellite operations was also allowed to the extent of 50% insofar as AsiaSat 1 was concerned and 75% insofar as AsisSat 2 was concerned. As regards the claim for depreciation, he accepted the contention of the appellant that depreciation would have to be allowed on the actual cost of the satellite and not on a notional written down

value which was computed as if depreciation had been allowed i the earlier years. However, he rejected the contention of the appellant that it was entitled to a deduction by way of depreciation on the entire cost of the asset by relying on Section 38 of the Act. He held that the C Band of AsiaSat 2 generated only 75% of the total revenues of AsiaSat 2, and therefore, 75% of the depreciation that was calculated on the actual cost ought to be allowed as a deduction. He considered the question as to what portion of the income so arrived at was to be considered chargeable to tax in India. He noted that the AO had not given any reason as to why 80% of the revenues should be attributed to India. He also noted that the appellant was located in Hong Kong and, therefore, a substantial part of its business was likely to come from clients of Chinese and Japanese origin. He rejected the appellant's contention that the test to be applied whilst pro-rating the income would be either the number of countries which are covered by the footprint or the Gross National Product (GDP) per capita of the countries covered by the footprint. He held that appropriate ratio to be applied would be the area of the country to the total area of the footprint with areas of large water bodies like inland lakes, seas and oceans being ignored. He also cancelled the levy of interest under Section 234B of the Act, but upheld the levy of interest under Section 234A of the Act.

The Order of the Income Tax Appellate Tribunal: The Impugned Order

15. Aggrieved by the said order, both the appellant as well as the AO field appeals before the Tribunal, which appeals were consolidated

and heard together and have been dispose of the appeals by common order dated 01.11.2002. The Tribunal first addressed the issue as to whether income of the appellant was chargeable to tax in terms of Section 9(1)(i). It held that no income accrued to the appellant from any property in India or from an asset or source in India or through the transfer of a capital asset situated in India. It, however, held that the appellant could be said to have a business connection in India because according to the Tribunal, in order to constitute a business connection, the test to be applied was that there must be an activity of the non-resident in India having an intimate relationship of a business character with the business of the non-resident which contributes to the earning of the profit by the non-resident in his business. According to the Tribunal, the activity of the appellant was to amplify and relay the signals over the footprint once the signals were uplinked to the satellite by the TV channels. The Tribunal concluded that the obligation of the appellant was to make available programmes of the TV channels in India through the transponder on its satellite. The appellant could acquire the right to receive its income only if the programmes were made available in India, and therefore, the Tribunal held that the appellant would have a business connection in India.

16. The Tribunal further held that no part of the appellant's income was chargeable to tax in India in terms of Section 9 (1) (i) as no operations to earn the income were carried on in India. The Tribunal held that in order to establish that the business operations were carried out in India, it was necessary to point out

that some part of the appellant's operations were carried out i the territory of India. The Tribunal found that the appellant had no office or agent or subsidiary in India which acted between it and the cable operators in facilitating the receipt of the signals. No machinery was installed by the appellant in India through which the programmes were reaching India. The Tribunal further found that the Department had not brought to its notice any operation which was done by the appellant in India and hence it held that the provisions of Section 9(1)(i) would have no application.

17. The Tribunal next dealt with the question as to whether the provisions of Section 9(1)(vi) would be attracted. The Tribunal noted that the only operation conducted by the appellant was confined to receiving the signals, amplifying them and after changing the frequency, relaying them back to earth. However, the Tribunal held that the word "used" in clause (iii) of Explanation 2 to Section 9(1)(vi) must be given the meaning which it has in common parlance. According to the Tribunal it was not necessary that there must be a physical connection with the item to the used. It is held that as long as the user derived advantage out of the property by amplifying the signals, it would tantamount to "use" within the meaning of clause (iii). It further held that there was a physical contact of the signal of the TV channels with the process in the transponder provided by the appellant. It was only when the signals came into contact with the process in the transponder that the desired results were produced. Therefore, the Tribunal concluded that the TV channels were using transponder capacity so as to enable the cable operators to

receive the programmes. The Tribunal further held that "process referred to in clause (iii) need not necessarily be a secret process as the word "secret" only qualified "formula". The Tribunal thereafter referred to several dictionary meanings of the word "process" as well as the published material filed by the appellant and concluded that the TV channels were using the process made available by the appellant through its transponder. The function of the satellite in the transmission channel was to receive the modulated carrier that the earth station emits, to amplify it and thereafter relay it for reception at the destination earth station.

18. According to the Tribunal, considering the role of the appellant in the light of the meaning of the term "process", it became evident that the "particular end" viz. viewership by public at large was achieved only through a series of steps taken by receiving the uplinked signals, amplifying them and relaying them after changing the frequency in the footprint area which would include India. As per its findings, the TV channels were not merely using the facility but were using a process as a result of which the signals after being received in the appellant's satellite were converted to a different frequency and after amplification were relayed to the area covered by the footprint. The Tribunal held that judgment of the Madras High Court in ***Skycell Communications Ltd.*** Vs. ***DCIT*** **[251 ITR 53)** relied upon by the appellant was distinguishable on facts and would not apply. The Tribunal thereafter considered the applicability of the decision of the Madras Bench in the case of ***Raj Television Network Ltd.*** It held that the said decision need not be followed inasmuch as the

Madras Bench did not have the advantage of considering variou arguments regarding process and other aspects of royalty as were urged before it. The Tribunal found that the transponder was not "equipment" and hence the payment made by the TV channels to the appellant could not be regarded as one for use of equipment. The Tribunal held that the appellant had not leased out any equipment but had only made available the process that was carried out in the transponder to its customers.

19. As regards the contention that even if the payment was to be regarded as one falling within the definition of royalty, nevertheless, as the TV channels were non residents, the income could not be brought to tax by virtue of sub-clause (c) of Section 9(1)(vi), the Tribunal held that the TV channels were using the services of the appellant for the purpose of their business, which business was being carried on in India. The Tribunal took the view that business is carried on at a place where some activity capable of producing income is carried on. The source of income of the TV channels were the Indian advertisers who made payment for advertising their products during the course of the relay of the programmes in India. The other source of revenue was the cable operators who caught the signals and distributed them to the public. According to the Tribunal, therefore, the essential activity was to make available the programmes of the TV channels in India and, therefore, they found that the TV channels would be carrying on business in India. The Tribunal also held that in any event, the source of the income of the TV channels would certainly be in India. It accepted the appellant's contention that the source did

not refer to the persons who made the payment but referred t the activity which gave rise to the income. According to the Tribunal, it was the ultimate viewership of the programmes transmitted by the TV channels which actually produced the income and, hence, the source of income of the TV channels must be regarded to be in India. The Tribunal held that the TV channels could earn income in many forms such as receipts from advertisers or from cable operators. The possibility of a channel not earning income from any source in India also could not be ruled out and in such an eventuality, the lease rentals earned by the appellant from such TV channels could not be assessed to tax in India under Section 9 (1)(vi). On this premise, the AO was been directed to determine the income chargeable to tax after giving an adequate opportunity of being heard to the appellant.

20. The Tribunal, thereafter, considered whether it would be open to the Revenue to raise an additional ground to urge that the amount received would be chargeable to tax under Section 9(1)(vii) as a fee for technical service. The Tribunal held that it would be open to either party viz., an assessee or the revenue to raise a legal ground before the Tribunal for the first time and if the ground is only a legal ground which does not require consideration of any fresh facts, it was not only the right of the parties but the duty of the Tribunal to admit the ground. According to the Tribunal, all the facts necessary for adjudication of the issues as to whether the amount received was chargeable to tax under Section 9(1)(vii) were available on record and hence they considered it appropriate to admit the additional ground. However, having admitted the

additional ground, the Tribunal felt that it was not necessary t deal with the same inasmuch as it had already upheld the contention that the amount was chargeable to tax in terms of Section 9 (1)(vi).

21. The Tribunal, thereafter, proceeded to consider the manner of computation of the income. The Tribunal held that the provisions of Section 44D would be inapplicable and hence the appellant would be entitled to a deduction of the expenditure incurred by it. The Tribunal held that the income received by the appellant would be chargeable to tax under the head "Profits and gains of business or profession". Therefore, the Tribunal held that the computation would have to be made in accordance with Chapter IV D. The Tribunal stated that if the starting point of the computation of the total income was only the revenue relatable to India, then, only the proportionate expenses relating to India should have been deducted rather than deducting the expenses in total from the net revenue relatable to India and thereafter apportioning the net income of the South Beam and C Band to India. The Tribunal, therefore, set aside the computation and directed that it would be done *de novo* by the AO. The computation to be done would involve two steps. First, the AO would have to calculate the gross receipts relatable to India and thereafter deduct therefrom the expenses in relation to income attributable to India.

22. Having said so, the Tribunal then dealt with the question as to what was the depreciation that would be allowed to the appellant. The Tribunal held that there was a difference between income which was exempt from income-tax and income which was outside

the scope of the charging provision. The Tribunal held tha depreciation allowable to the appellant had to be apportioned. However, the Tribunal accepted the contention of the appellant that the depreciation would be allowable on the actual cost and not on the written down value calculated on the basis of a notional allowance of depreciation. The Tribunal also upheld the contention of the appellant that the provisions of Section 44C would not be attracted and hence the disallowing provisions thereof would be inapplicable.

23. As regards the levy of interest under Sections 234A and 234B was concerned, the Tribunal held that the appellant would be liable to pay interest under Section 234A. However, with regard to levy of interest under Section 234B, the Tribunal held that if the receipt of income by the appellant was of such a nature on which tax was deductible, then, the appellant would not be obliged to pay advance tax and consequently there would be no liability to interest. It, therefore, directed the AO to examine whether the amount of tax deductible by the TV channels by virtue of the provisions of Section 195 was equal to or more than the tax payable by the appellant, and if so, then no liability to pay interest under Section 234B would arise. If however, the tax deductible was less than the tax payable by the appellant, the difference would be considered for the purpose of levy of interest under Section 234B.

Relevant Statutory Provisions:

24. Chapter II of the Income Tax Act under the caption "Basis of Charge" enumerates various provisions on the basis on which income of a person is exigible to tax in India. Section 4 is the charging Section. Section 5 delineates the 'scope of total income'. Sub-section (1) thereof deals with total income earned by a resident with which we are not concerned in the instant case, as the appellant is admittedly a non-resident. It is the sub-section (2), which is relevant for a non-resident, which reads as under:

> **"Section 5(2)**
>
> (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which –
>
> (a) Is received or is deemed to be received in India in such year by or on behalf of such person; or
>
> (b) Accrues or arises or is deemed to accrue or arise to him in India during such year.
>
> *Explanation 1 :* Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.
>
> *Explanation 2 :* For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

25. It is clear from the reading of the aforesaid provision that a non-resident is liable to pay tax on the income derived by him, which is received or deemed to be received in India or which accrues or arises or is deemed to accrue or arise in India during the relevant year. Thus, a non-resident is under an obligation to pay tax in respect of income generated/earned by him in India. Section 9 of the Act lays down the various circumstances under which income would be deemed to accrue or arise in India. We are concerned

herewith Clause (i), (vi) and (vii) therefore, we are extractin below only those portions of this provision and omitting other portions of this lengthy Section:

"Section 9

(1) The following incomes shall be deemed to accrue or arise in India :- (i) All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India;

Explanation [1] : For the purposes of this clause - (a) In the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India; .....

....

....

(vi) income by way of royalty payable by—

(a) the Government ; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government :

Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.

Explanation [2]:.....

(iii) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

xxx xxx xxx

(vi) The rendering of any services in connection with the activities referred to in sub-clauses (i) to (v);

xxx xxx xxx

(vii) Income by way of fees for technical services payable by -
(a) The Government; or

(b) A person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) A person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government."

RE: Areas of Controversy:

26. The facts noted above would demonstrate that the endeavour of the Revenue is to bring the case of the appellant within the mischief of all or any of the aforesaid clauses (i), (vi) and (vii) of sub-section (1) of Section 9 of the Act in order to bring the appellant within the tax net in India. For applicability of Clause (i),

it is necessary to establish that the appellant has busines connection in India. It is also necessary to establish that the appellant was carrying out some operation in India from which the income was earned in this country. Though the Tribunal has held that the appellant has business connection in India, it has also returned the findings that no operation was done by the appellant in India and therefore, Section 9(1)(i) of the Act would have no application. The appellant has challenged the finding of the Tribunal holding that it had a business connection in India. However, it was accepted at the bar that in case the finding of the Tribunal that there was no operation in India is affirmed, issue as to whether the appellant had business connection in India would be of academic interest.

27. Insofar as income earned by the appellant from its customers in India is concerned, the Tribunal has held that this would qualify as 'royalty' as defined in Explanation 2 to Section 9(1)(vi) of the Act.

28. As far as applicability of Clause (vii) of Section 9(1) of the Act is concerned, though this was an issue raised by the Revenue for the first time before the Tribunal, the Tribunal admitted the additional ground as purely legal, at the same time the Tribunal also refused to answer this issue. Basically, therefore, issues which arise for consideration in this appeal concern Clauses (i), (vi) and (vii) of sub-Section (1) of the Section 9 of the Act and we proceed to deal with these issues in that order.

Re: Applicability of Section 9(1)(i):

29. The Tribunal has held that even when the appellant has busines connection in India, no part of the appellant's income was chargeable to tax in India in terms of Section 9 (1) (i) as no operations to earn the income were carried on in India. The Revenue in its appeal has challenged this finding of the Tribunal. On the other hand, the appellant is aggrieved against that part of order, which holds its business connection in India and the contention is that the appellant does not even have business connection in India.

30. We have already reproduced the provision of Section 9(1)(i) of the Act along with Explanation 1 thereof. In order to succeed, the Revenue has to prove that the income has accrued or arisen, whether directly or indirectly in India, i.e. (a) through or from any business in India; or (b) through or from any property in India; or (c) through or from any assets or source of income in India; and (d) through or from transfer of capital assets situate in India. The case is sought to be covered only on the premise that the income to the appellant accrued or arisen through or from business connection in India. Explanation 1 clarifies that if a business of which all operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. In order to bring the case within this clause, it was stressed by the learned counsel for the Revenue that the business of the appellant was to help its clients who were the TV channels , in relaying their programmes from the satellites in the footprint including India. It was explained that the

TV channels were uplinking their programmes and after th receipt of the signals at the satellite and processing through various processes embedded in the transponders, the appellant was making available the signals in the footprint area including India; agreements were entered into with these clients by the appellant to ensure that the programmes are made available in India and it was the duty of the appellant to make available those programmes in India. Therefore, urged the learned counsel, not only there was a direct business connection of the appellant in India, income which was received as a result of these operations should be treated as received or accrued or arisen in India. It was argued that Explanation 1 created a fiction by laying down a deeming provision. It was also argued that the words 'directly or indirectly' used in Clause (i) of sub-section (1) of Section 9 of the Act clearly demonstrated that wider possible interpretation tot his deeming provision was to be given. It was the endeavour of the learned counsel to demonstrate that a causal link was established to attract the deeming provision inasmuch as the appellant by providing its services to the TV channels was making it possible for those TV channels to relay their programmes in India and the viewers watching those programmes as well as cable operator located in India were making payments to the TV channels and these TV channels were in turn out of those earnings were making payments to the appellant with whom these TV channels were directly connected.

31. On the other hand, Mr. S. Ganesh, learned Senior counsel appearing for the appellant, submitted that the Tribunal with well

supported reasoning had arrived at the conclusion that income di not accrue or arise in India under Clause (i) of sub-section (1) of Section 9 of the Act and heavily relied upon the same.

32. After considering the respective submissions, we are of the view that the findings of the learned Tribunal on the non-applicability of Section 9(1)(i) of the Act are proper, justified and legally sustainable. We have already taken note of the Explanation (a) to this sub-clause, which lays down that in the case of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. It, thus, clearly follows that carrying out the operations in India, wholly or at least partly, is *sine qua non* of the application of Clause (i) of sub-section (1) of Section 9 of the Act. Can it be said that the appellant, under the given circumstances, is doing some business in India, i.e., is there any business act of the appellant which could be attributed to the Indian territory? Under the agreement with TV channels, role attributed to the appellant can be paraphrased in the following steps:

(i) Programmes are uplinked by the TV channels (admittedly not from India).

(ii) After receipt of the programmes at the satellite (at the locations not situated in India airspace), these are amplified through complicated process.

(iii) The programmes so amplified are relayed in th footprint area including India where the cable operators catch the waves and pass them over to the Indian population.

33. Accepted position is that the first two steps are not carried out in India and the entire thrust of the Revenue is limited to the third step and the argument is that the relaying of the programmes of in India amounted to the operations carried out in India. Whether this argument is sustainable? Answer is emphatic no! Merely because the footprint area includes India and the programmers by ultimate consumers/viewers are watching the programmes in India, even when they are uplinked and relayed outside India, would not mean that the appellant is carrying out its business operations in India. The Tribunal has rightly emphasized the expressions "operations" and "carried out in India" occurring in Explanation (a) to hold that these expression signify that it was necessary to establish that any part of the appellant's operations were carried out in India. No machinery or computer, etc. is installed by the appellant in India through which the programmes are reaching India. The process of amplifying and relaying the programmes is performed in the satellite which is not situated in the Indian airspace. Even the Tracking, Telemetering and Control (TTC) operations are also performed outside Indian in Hong Kong. No man, material or machinery or any combination thereof is used by the appellant in the Indian territory. There is no contract or

agreement between the appellant either with cable operators c viewers for reception of signals in India.

34. We, thus, hold that Section 9(1)(i) is not attracted in the present case.

Re: Applicability of Section 9(1)(vi)

35. The Tribunal has covered the case of the assessee under this provision and therefore, it is the subject matter of challenge in the appeal filed by the appellant. To recapitulate briefly the process of transmission of TV programmes, it starts with TV channels (customers of the appellant) uplinking the signals containing the TV programmes; thereafter the satellite receives the signals and after amplifying and changing their frequency relays it down in India and other countries where the cable operators catch the signals and thereafter distribute them to the public. If any person has got dish antenna, he can also catch the signals relayed from these satellites. The role of the assessee in this cycle is that of receiving the signals, amplifying them and after changing frequency relaying them on the earth. It is for this service, the TV channels make payment to the assessee. The learned CIT(A) held that the payment so made by the customers was in the nature of royalty liable to tax under Section 9(1)(vi) of the Act.

36. Royalty is given a specific meaning in Explanation 2 which has already been extracted above. The Tribunal is also in agreement with the conclusion of the CIT(A) and the reasons which led to taking this view by the Tribunal have also been stated above.

37. The basic submission of Mr. Ganesh was that the service charge received by AsiaSat from its customers are not "royalty" because the said charges are not recovered for the use of any equipment or process as such by the customer. AsiaSat renders services to its customers by operating and using the transponders on the satellite. It is emphasized that the satellites and their operations, and the processes by which the satellites operate, are used only by AsiaSat and not by AsiaSat's customers, because AsiaSat has complete control over the operation of the satellites and AsiaSat's customers have no control over them. The operation of the transponder involves reception of a wireless signal at a particular frequency, selection of the component equipment which combine to form the transponder by means of commands through AsiaSat's Telemetry, ("TT&C"), conversion of the signal to another frequency, amplification of the signal and retransmission of the same. There is no confidential or protected intellectual property which is at all involved in any of these operations, and further, in any event, the equipment and the process involved in the operation thereof are used by AsiaSat and not by its customers. As the customer does not utilize the said equipment or the process involved in its operations, the charges paid by it to AsiaSat are not covered by Clause (iii) of Explanation 2 to Section 9(1)(vi) of the Act and therefore, the same are not "royalty".

38. The learned Senior counsel referred to and gave his own analysis to the Standard Agreement entered into by AsiaSat with its customers, which is summarized below:

Definition of 'AsiaSat 1' as per which, the appellant is th operator of the satellites. Clause 3.2(ii) and (iii), Clause 3.4 as per which, submitted the learned Senior counsel, not only the appellant is the operator of the satellite and to obtain the requisite licenses to operate the satellite and maintain the same, the appellant remains in the control of this satellite and is in fact prohibited from giving control of operation of satellite or any part thereof to its customers.

39. He also referred to the ruling of the Authority for Advance Rulings (AAR) in the case of ***ISRO Satellite Centre [ISACT]*** Vs. **Commissioner concerned DIT (Intl. Taxation) [307 ITR 59]** pointing out that the process of operation of a satellite and the role played by the transponder therein and the control and operation of the transponder have been discussed in detail in the Ruling in the said judgment. It was argued that this judgment gives the definition and explains the working of the transponder. Every transponder receives a signal at a particular frequency and retransmits it at a different frequency over the footprint area of the satellite. This is the process employed in the transponder. Further, the transponder may also amplify the signal before retransmitting it. In the ***ISRO (supra)*** case, there was no amplification of the signal, but the ruling of the AAR is not based or founded on this fact as such. The learned counsel emphasized that ratio of the aforesaid Ruling was that where transponder and the process therein are actually utilized by the satellite operator for rendering a service to the customer, it cannot be said that the transponder or process employed therein are used by the

customer. On this premise, it was argued that the question c receiving any royalty for 'use' of the transponder does not arise, as there was no such user.

40. Reliance was also placed on the judgment of the Supreme Court in the case of ***Bharat Sanchar Nigam Ltd. and Anr.*** Vs. ***Union of India (UOI) and Ors.*** **[282 ITR 273]** wherein the Apex Court laid down the crucial significance of holding the license required to operate the equipment in question. It is only the person who holds the requisite license as required by the statute, who can be said to operate, use and control the equipment in question,. In the present case, the license required by the statute for operating the satellite and all its parts, components and systems is held only by AsiaSat and not by its customers. Further, AsiaSat is prohibited from parting with control of any part of the operations of the satellite to its customers.

41. It was also argued that the essence of the agreement was required to be seen and nomenclature as held by the Supreme Court in the case of ***Puran Singh Sahini*** Vs. ***Sundari Bhagwandas Kripalani & Ors.*** **[(1991) 2 SCC 180]**. On the reading of the agreement with the customers, argued the learned Senior counsel, it was clear that the appellant had not leased out the equipments to the customers. On the contrary, the equipment was used by the appellant as its owner only to provide and render services to its customers, which was a vital distinction brought out clearly by the Karnataka High Court in the case of ***Lakshmi Audio Visual Inc.*** Vs. ***Assistant Commissioner of Commercial Taxes (Kar.)*** **[124 STC 426]**, which reads as under:

"9. Thus if the transaction is one of leasing/hiring/letting simpliciter under which the possession of the goods, i.e., effective and general control of the goods is to be given to the customer and the customer has the freedom and choice of selecting the manner, time and nature of use and enjoyment, though within the frame work of the agreement, then it would be a transfer of the right to use the goods and fall under the extended definition of "sale". On the other hand, if the customer entrusts to the assessee the work of achieving a certain desired result and that involves the use of goods belonging to the assessee and rendering of several other services and the goods used by the assessee to achieve the desired result continue to be in the effective and general control of the assessee, then, the transaction will not be a transfer of the right to use goods falling within the extended definition of "sale". Let me now clarify the position further, with an illustration which is a variation of the illustration used by the Andhra Pradesh High Court in the case of Rashtriya Ispat Nigam Ltd. v. Commercial Tax Officer.

Illustration :

(i) A customer engages a carrier (transport operator) to transport one consignment (a full lorry load) from place A to B, for an agreed consideration which is called freight charges or lorry hire. The carrier sends its lorry to the customer's depot, picks up the consignment and proceeds to the destination for delivery of the consignment. The lorry is used exclusively for the customer's consignment from the time of loading, to the time of unloading at destination. Can it be said that right to use of the lorry has been transferred by the carrier to the customer ? The answer is obviously in the negative, as there is no transfer of the "use of the lorry" for the following reasons : (i) The lorry is never in the control, let alone effective control of the customer ; (ii) the carrier decides how, when and where the lorry moves to the destination, and continues to be in effective control of the lorry ; (hi) the carrier can at any point (of time or place) transfer the consignment in the lorry to another lorry ; or the carrier may unload the consignment en-route in any of his godowns, to be picked up later by some other lorry assigned by the carrier for further transportation and delivery at destination.

(ii) On the other hand, let us consider the case of a customer (say a factory) entering into a contract with the transport operator, under which the transport operator has to provide a lorry to the customer, between the hours 8.00 a.m. to 8.00 p.m. at the customer's factory for its use, at a fixed hire per day or hire per km subject to an assured minimum, for a period of one month or one week or even one day ; and under the contract, the transport operator is responsible for making repairs apart from providing a driver to drive the lorry and filling the vehicle with diesel for running the lorry. The transaction involves an identified vehicle belonging to the transport operator being delivered to the customer and the customer is given the exclusive and effective control of the vehicle to be used in any

manner as it deems fit ; and during the period when the lorry is with the customer, the transport operator has no control over it. The transport operator renders no other service to the customer. Therefore, the transaction involves transfer of right to use the lorry and thus be a deemed sale."

42. Mr. Ganesh also submitted that the language of Section 9 1(vi) was almost verbatim and identical to the language which also had earlier been used in international tax treaties. In that international tax treaties, the term 'royalty' came up for discussion before the Courts in the following cases:

a) ***Commissioner of Income Tax*** Vs. ***Ahmedabad Manufacturing and Calico Printing Co.*** **[139 ITR 806 (Guj)].**

b) ***Commissioner of Income Tax*** Vs. ***Vishakhapatnam Port Trust*** **[(1983) 144 ITR 146 (AP).**

c) ***N.V. Philips*** Vs. ***Commissioner of Income Tax*** **[172 ITR 521].**

d) ***Commissioner of Income Tax*** Vs. ***Neyvali Lignite Corporation Ltd.*** **[243 ITR 459 (Mad.)].**

43. It was, thus, urged that the same meaning to the term 'royalty' should be assigned while interpreting Section 9(1)(vi) as well. He emphasized that one has to keep in mind that every item in Clause (iii) of Explanation 2 to Section 9(1)(vi) refers to an item of intellectual property. The doctrine of *noscitur a sociis*, therefore, applies squarely to the interpretation of Clause (iii) of Explanation 2 to Section 9(1)(vi). This doctrine has been applied by this Court in the case of ***Commissioner of Income Tax*** Vs. ***Bharti Cellular Ltd.*** **[175 Taxman 573]** for the interpretation of Explanation 2 to

Section 9(1)(vii). Therefore, the term "process" occurring i Clause (iii) of Explanation 2 to Section 9(1)(vi) means a process which is an item of intellectual property. The process employed in the transponder of a satellite, i.e., of changing the frequency and amplifying the signal is not at all an item of intellectual property because that process has been in the public domain for more than half a century. The payment received by AsiaSat from its customers is, therefore, not a payment for the use of the process employed in the transponder any more than the payment made by a customer using a chauffeured private taxi is for the use of the internal combustion engine in the car.

44. It was further submitted that Section 9(1)(vi)(c) only applies where the use of the process in question has taken place in India, just as it was held by the Supreme Court in the case of ***Ishikawajima-Harima Heavy Industries Ltd.*** Vs. ***DIT*** **[(2007) 288 ITR 408 (SC)]** that Fee for Technical Services is taxable in India under Section 9(1)(vii)(c) only if such technical services are rendered in India. The language of Section 9(1)(vi)(c) is similar to that of Section 9(1)(vii)(c) and therefore, the ratio of ***Ishikawajima-Harima Heavy Industries Ltd. (supra)*** case applies squarely to the interpretation of Section 9(1)(vi)(c).

45. Mr. Sanjeev Sabharwal, learned counsel for the Revenue, staunchly refuted the aforesaid contentions. His first submission was that whether the appellant had control over the satellite or not makes no difference having regard to the language of the provision. He drew our attention to sub-section (3) of Explanation

2 which according to him, merely states 'use of standard facility

His submission was that:

a) 'Use' in context means only 'usage simpliciter' and nothing more;

b) Legislature has 'intentionally' used the expression 'use' because in other sub clause of Explanation 2 to Section 9(1)(vi) wherever required expression used is 'use or right to use';

c) In view of the aforesaid distinction maintained deliberately by the legislature, hence it is not the case of '*causus omissus*;

d) Thus, according to the respondent it makes no difference in what capacity the appellant allows someone to use the process.

46. His alternate submission was that even if the control is relevant, the same was with the customer (whom the services were provided). For this purpose, he referred to the definition of transponder, which makes a difference between satellite as carrier and the transponder. According to him, what is relevant is the 'control of the transponder' and not the satellite which merely is a carrier, i.e., Nuclear Warhead has two parts, Carrier or rocket and 'payload' or 'bomb'. Further to determine control, the agreement needs to be examined. The agreement states:

1. Transponder no. 7H is identified and earmarked for the assessee.
2. Page 284/285 gives the appellant not only exclusive lease right but also right to sublease in clause 10 of course safeguarding appellant's commercial interests from competitions.

3. Page 189/290 gives exclusive right of enjoyment t broadcaster. It even is entitled to damages in case the broadcaster curtails its form of agreement of 12 years, determining damages of 'unutilized period of lease'.
4. Decision of this Court in the case of ***Antrix Satellite*** has held it to be a case of control vested in the earth station users.
5. Exhibit at 2/5 of the paper book provides:
   a) Exclusive frequency to broadcaster.
   b) Bandwidth for broadcaster including encryption code.
   c) Broadcaster to define the uplinking programmes and time.
   d) Broadcaster to use the process embedded in the transponder.
   e) Broadcaster to define in which area/footprint the satellite is to relay.
6. Physical control is neither necessary nor warranted in present context. The control of satellite is with appellant. However, more relevant and effective control of the 'use' of the transponder is with the broadcaster.

47. Mr. Sabharwal also joined the issue with the learned counsel on the applicability of the judgment in the case of ***ISRO (supra)***. He submitted that the appellant was not right in relying upon the ***ISRO (supra)*** because of the following reasons:

   a) ISRO's case does not apply to the facts of the present case.

b) The difference lies in the type of the transponder being used. There are two types of transponder being used, i.e., Active or Passive.

c) The difference as recognized is that the process of "Amplification" takes place in the communication active satellite whereas not in the case of passive satellite.

d) Authority of Advance Rulings was well aware of the same while dealing with facts of the ISRO's case and even put a question to the assessee about the same.

48. He also submitted that argument of the appellant that sub-clause (iii) to Explanation 2 is limited to IPR as 'process' on the application of the principle of *noscitur a sociis* was incorrect for the following reasons:

a) That the work 'process' in sub clause (iii) refers to the 'process per se' for the reason that 'process' being a generic word is preceded by 'patent' – which would always include 'process patent' therefore in case patent is not protected, then over a period of time becomes 'process of general application' and thus no infringement is possible.

b) The distinction is not only maintained between 'patent' and process but patent is followed by 'process' and thus the legislature while using the word process was aware of the restrictive meaning

patent connotes and hence in income tax act it has been given a 'wider' definition.

c) The usage of the wider word after restrictive word would show the intention of the legislature is to give it an extended meaning.

d) Lastly and more importantly, sub-clause (vi) to Explanation 2 further extends its meaning by stating that even 'any services' – all services which are not IPR proper are included.

'In connection with' - which would include any service 'related to or in connection with' would also be included. In this regard, reference be made to HOME Solution's case.

'Activities stand in Sub –clause (iii)' - Thus reiterating the difference further and extending it to include more than mere IPR.

49. He also referred to Article 12-Royalties in the book "Interpretation and Application of Tax Treaties" by Ned Shelton. This article with captioned 'Royalties' makes reference to satellite services and states that:

(i) They were always included; and

(ii) In fact for removal of doubts/to clarify Australian Canadian DTAA has been even amended.

Following passage from the book was relied for this purpose:

> "An increasingly important issue is the treatment of payments made for satellite services. There has been a view in one particular country, for example, at least by tax officials there, that payments by customers for satellite TV services is a royalty. Separately, as an illustration of the importance of this area, the definition of royalty in the Australia – Canada Treaty (1980) has recently been broadened. The following is a comment on the new provision from the Australian tax authorities made in January, 2002:
>
> > "27. The definition of royalties has been expanded in conformity with current Australian tax treaties practice (Article 12). The definition now specifically includes payments for the reception or use of transmissions by satellite, cable, fiber optic or similar technology (Article 12 (8), as well as reproduction techniques in connection with television (Article 12 (3)). These were inserted in order to remove any doubt as to whether they were covered by the previous definition. The definition also specifically excludes payments for the use or acquisition of source code of software that is granted purely to enable effective operation of the program by the user."
>
> Para (3) can be said to deal with 'know-how'. Payments made purely for the use of know-how constitute royalties. 'Purely' in this context means that the provider of the know-how does not provide additional services to the user. If, for instance, the contract also involves technical assistance, the character is mixed and the payment should be split into a part considered a royalty (to which Article 12 applies) and a part considered a service payment (to which Article 7 applies). Payments for services and advice given by engineers, lawyers or accountants do not constitute royalties, but are covered by Article 7. The same applies to payments made for management and similar services. It should be noted, however, that this is often ignored by source countries; consequently, these countries (particularly developing countries) frequently subject such payments to a withholding tax on royalties."

50. Mr. Sabharwal also argued that the 'process' in sub-clause (iii) need not be 'secret' and following justification was sought to be given for this argument:

(a) The 'secret' is prefixed to the word formula and not to 'process'.

(b) Sub-clause (iii) states "a secret formula or process c Trademark or similar property" and in case "secret" is to be prefixed to "process" as well it needs to be also prefixed to trademark and in such a case why would anyone pay royalty for use of trademark.

(c) Importantly 'patented process' will be protected but 'process' if not registered will be widely used and hence, there is no question of same being 'secret also.

(d) Alternatively, even assuming for the argument that the 'process' is IPR, the same merely gives right to control the use. In present context it will mean that "**Access to process is restricted/checked or made secure and thus process kept for intended user".** However, the same has been used it being **"unknown process or unknown mysterious entity".**

(e) IPR even otherwise, has to do with commercial exploitation after recognition of right in process, which is not same thing as it being "secret". The exclusive right has been recognized of assessee and broadcaster is being given 'use of process' right through restrictive access.

Thus, it was submitted that 'process need not be secret' but should protect the commercial interest of the appellant, which is protected in the agreement.

51. His next submission was that the payment of interest, royalty and fee for Technical Services (FTS) need not have territorial nexus as

the same is governed by 'Source Rule'. He explained 'Sourc Rule' to mean that the country from which the services are utilized/payments are made, would determine territorial jurisdiction. Dealing with the judgment of the Supreme Court in ***Ishikawajima-Harima Heavy Industries Ltd. (supra)***, he submitted that it was held therein that country from which services are 'received' will have jurisdiction. The said decision was rendered on 06.01.2007 by the Supreme Court. According to him, this principle is not applicable for following reasons:

(i) The Court was dealing the same in context of Permanent Establishment for offshore services.

(ii) However, Explanation to Section 9 was brought about immediately "clarifying and for removal of doubt" that 'source rule' was always intended by introduction of sub-section (v), (vi) and (vii) to Section 9(1) of the Act with effect from 01.06.1976.

(iii) Importantly the said Explanation as clarification not only brought about immediately in the said Finance Bill of 2007 (normally introduced in February of every year in Parliament).

(iv) The Memorandum of Understanding explaining the said Explanation stated at the time of introduction of the bill clearly referred to certain contrary view in some "decisions".

(v) The said source was further clarified by Finance Act, 2010 by introduction of Clause (ii) to the Explanations.

In nutshell, he submitted that the territorial nexus is not relevar in taxing the 'satellite services'/'utilization of segmented transponder capacity' and is to fall in the tax jurisdiction of the source country, i.e., where services are utilized in regard to use of process embedded in the active transponder, [control whereof is with the broadcaster] and in view of use of word "process", which does not have to be 'secret' but having restrictive access to be commercially exploitable.

52. The entire controversy revolves round the interpretation which is to be given to sub-clause (vi) of Section 9(1) of the Act. This sub-clause makes income by way of royalty payable by certain persons as chargeable to tax. These persons pay the 'royalty' made either by the Government or a resident or a non-resident. We have to keep in mind that Section 9 of the Act is a deeming provision and if the situation specified therein exists, it is to be deemed that income has accrued or arisen in India. The term 'royalty' is assigned a specific meaning in Explanation 2 to sub-clause (vi) of Section 9(1) of the Act. We have already pointed out above that in this case, we are concerned with sub-clause (i), (iii) and (vi) of the said Explanation. Though these sub-clauses have already been reproduced above, for the sake of continuity in our discussion, we take note of these sub-clause once again, which are as follows:

> "(i) The transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
>
> xxx xxx xxx
>
> (iii) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

xxx xxx xxx

(vi) The rendering of any services in connection with the activities referred to in sub-clauses (i) to (v);"

53. Sub-clause (i) deals with the situation when the rights in the intellectual property of the nature specified therein are transferred. This transfer includes 'the granting of a licence' as well. As per sub-clause (iii), even when the kind of intellectual property therein is allowed to be used, consideration paid for use thereof would qualify for my 'royalty'. Sub-clause (vi) makes it wider as payments made even when any services are rendered in connection with activities referred to in sub-clauses (i) to (iv), (iva) and (v), those payments are to be termed as 'royalty' for the purpose of Section 9.

54. Having commented broadly upon the nature of 'royalty' specified in the aforesaid provision and before we interpret the provisions with reference to certain specific language used therein, we deem it apposite to lay down the ground rules which are to be kept in mind before undertaking the exercise of interpretative process.

(1) It is to be kept in mind that Section 9 of the Act is a deeming provision and if the situation specified therein exists, it is to be deemed that income has accrued or arisen in India.

(2) Clause says that the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property.

(3) It is settled law that the words of a statute are first understood in their natural, ordinary or popular sense and phrases and sentences are construed according their grammatical meaning unless that leads to some absurdity or unless there is something in the context, or in the object of the statute to suggest the contrary. In a case if the language of the statute is not clear and there is need to resort to aids of construction, such aids can be either internal or external. Internal aids of constructions are definitions, exceptions, explanations, fictions, deeming provisions, headings, marginal notes, preamble, provisos, punctuations, saving clauses, *non obstante* clauses, etc. The external aids are dictionaries, earlier Acts, history of legislation, parliamentary history, parliamentary proceedings, state of law as it existed when the law was passed, the mischief sought to be suppressed and the remedy sought to be advanced by the Act. Therefore, need for these aids would arise only if some ambiguity is found in the definition of term 'royalty' as appearing in the aforesaid provision.

(4) As per Section 9(1)(vi) of the Act, the income by way of royalty payable by the Government or a resident; or a non-resident shall be deemed to accrue or arise in India. The term royalty has been defined in Explanation 2 to Section 9(1) (vi) of the Act. In the case of ***Keshavji Ravji & Co.*** Vs. ***CIT*** [(1990) 183 ITR

1 (SC), the Supreme Court said that an Explanatio generally speaking, is intended to explain the meaning of certain phrases and expressions contained in the statutory provisions. There is no general theory as to the effect and intendment of an Explanation except that the purpose and intendment are determined by its own words. An Explanation depending upon its own language might supply or take away something from the contents of a provision. It is also true that an Explanation may be introduced by way of abundant caution in order to clear any mental cobwebs surrounding the meaning of the statutory provision spun by interpretative errors and to place what Legislature considers to be true meaning beyond any controversy or doubt. In view of decision of the Supreme Court in ***Keshavji Ravji & Co. (supra)***, Explanation 2 has to be read as part and parcel of Section 9 (1)(vi) of the Act.

(5) The Finance Act, 2007 inserted the following Explanation to Section 9 with retrospective effect from 01.06.1976, which reads as under:

> "Explanation – For the removal of doubts, it is hereby declared that for the purposes of this Section, where income is deemed to accrue or arise in India under clause (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India."

Further, by the Finance Act, 2010 with retrospective effect from 01.06.1976, the Explanation inserted by

the Finance Act, 2007 has been substituted by th following Explanation:

> "Explanation – For the removal of doubts, it is hereby declared that for the purposes of this Section, income of a non-resident shall be deemed to accrue or arise in India under Clause (v) or Clause (vii) or Clause (viii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not, -
>
> (i) the non-resident has a residence or place of business or business connection in India; or
>
> (ii) the non-resident has rendered service in India."

From plain reading of the Explanation inserted with effect from 01.06.1976 by the Finance Act, 2007 which has been again substituted by the Finance Act, 2010 with retrospective effect from 01.06.1976, it is clear that income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) irrespective of the fact whether the non-resident has a residence or a place of business or business connection in India or the non-resident has rendered services in India. Therefore, once the consideration is received by non-resident for the transfer or all or any rights including the granting of a licence in respect of a patent, invention, model, design, secret formula or process or similar property or any copyright literary, artistic or scientific work, the consideration received shall be deemed to accrue or arise in India and will be taxable in India.

(6) Section 90 of the Act provides relief from doubl taxation and reads as under:

> "90 (1) The Central Government may enter into an agreement with the Government of any country outside India - (a) For the granting of relief in respect of income on which have been paid both income-tax under this Act and income-tax in that country, or income tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or
>
> (b) For the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or
>
> (c) For exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or
>
> (d) For recovery of income-tax under this Act and under the corresponding law in force in that country, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
>
> (2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
>
> (3) Any term used but not defined in this Act or in the agreement referred to in sub-Section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.
>
> *Explanation* – For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less fafourable charge or levy of tax in respect of such foreign company."

(7) The four clauses of sub-section (1) lay down the scop of power of Central Government to enter into an agreement with another country. Clause (a) contemplates situations where tax has already been paid on the same income in both the countries and in that case it empowers the Central Government to grant relief in respect of such double taxation. Clause (b) of Section 90 which is wider than clause (a) provides that an agreement may be made for the avoidance of double taxation of income under this act and the corresponding laws enforced in that country. Clause (c) and (d) essentially deal with the agreements made for exchange of information, investigation of cases and recovery of Income-tax. The effect of an agreement made pursuant to the Section 90 is that if no tax liability is imposed under this Act, the question of resorting to agreement would not arise. No provision of the agreement can fasten a tax liability when the liability is not imposed by this Act. If a tax liability is imposed by this Act, the agreement may be resorted to for negativing or reducing it. In case of difference between the provisions of the Act and of an agreement under Section 90, the provisions of the agreement shall prevail over the provisions of the Act and can be enforced by an appellate authority or the Court. However, as provided by sub-section (2), the

provisions of this Act will apply to assessee in th event they are more beneficial to him. Where there is no specific provision in the agreement, it is the basic law i.e. the Income-tax Act which will govern the taxation of income.

55. Keeping in view the aforesaid principles, we now embark upon the interpretative process in defining the ambit and scope of term 'royalty' appearing in Explanation 2 to sub-clause (vi) of Section 9(1) of the Act. Sub-clause (i) deals with the transfer of all or any rights (including the granting of a licence) in **respect of** a patent, etc. Thus, what this sub-clause envisages is the transfer of "rights in respect of property" and not transfer of "right in the property". The two transfers are distinct and have different legal effects. In first category, the rights are purchased which enable use of those rights, while in the second category, no purchase is involved, only right to use has been granted. Ownership denotes the relationship between a person and an object forming the subject matter of his ownership. It consists of a bundle of rights, all of which are rights *in rem*, being good against the entire world and not merely against a specific person and such rights are indeterminate in duration and residuary in character as held by the Supreme Court in the case of ***Swadeshi Ranjan Sinha*** Vs. ***Hardev Banerjee*** **[AIR 1992 SC 1590]**. When rights in respect of a property are transferred and not the rights in the property, there is no transfer of the rights *in rem* which may be good against the world but not against the transferor. In that case, the transferee does not have the rights which are indeterminate in duration and residuary in

character. Lump sum consideration is not decisive of the matte That sum may be agreed for the transfer of one right, two rights and so on all the rights but not the ownership. Thus, the definition of term royalty in respect of the copyright, literary, artistic or scientific work, patent, invention, process, etc. does not extend to the outright purchase of the right to use an asset. In case of royalty, the ownership on the property or right remains with owner and the transferee is permitted to use the right in respect of such property. A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and, therefore, no royalty. In an outright transfer to be treated as sale of property as opposed to licence, alienation of all rights in the property is necessary.

56. As noticed above, the Tribunal has held that the appellant is deriving income from lease of transponder capacity of its satellites. The appellant is deriving income from lease of transponder capacity of its satellites. The appellant is amplifying and relaying the signals in the footprint area after having been linked up by the TV channels. The essence of the agreement of the TV channels with the appellant is to relay their programmes in India. The responsibility of the appellant is to make available programmes of the TV channels in India through transponders on its satellite. The function of the satellite in the transmission chain is to receive the modulator carrier that earth stations emitted as uplinking, amplifying them and retransmitting them and downlink for reception at the destination earth stations. The meaning of the word "process" being a series of action or steps taken in order to

achieve a particular end, considering the role of the appellant i the light of meaning of the term 'process', it is evident that the particular end, viz., viewership by the public at large was achieved only through the series of steps taken by receiving the uplinked signals, amplifying them and relaying them after changing the frequency in the footprint area including India. This is held that the TV channels in entire cycle of relaying the programmes in India were using the process provided by the assessee and, therefore, it is liable to be taxed as royalty income.

57. We have to test the rationality of the aforesaid reasoning and consider the attack thereupon by the appellants in their arguments recorded above. Before that, we may take note of few judgments relevant to the context. In the case of ***Commissioner of Income Tax*** Vs. ***Datacons P. Ltd.*** **[155 ITR 66 (Kar.)]**, the company was engaged in processing the data supplied by its customers by using IBM unit record machine computer. The assessee received vouchers and statements of accounts from its customers and converted them into balance sheets, stock accounts, sales analyses etc. They were printed as per the requirement of the customers. The Karnataka High Court held that in all these activities, the assessee had to play an active role by coordinating the activities and collecting the information. Such activities amounted to processing of goods. In the case of ***NV Philips*** Vs. ***Commissioner of Income Tax*** **[172 ITR 521],** the assessee received the amount for providing specialized knowledge of manufacturing particular commodity which included working methods, manufacturing process including indications,

instructions, specifications, standards and formulae, method c analysis and quality control. It was held that the payment for the user of such specialized knowledge, though not protected by a patent, was assessable as royalty. In the case of ***DCM Ltd.*** Vs. ***Income Tax Officer***, the issue related to transfer of comprehensive technical information know-how and supply of equipment. It was held that the collaboration agreement dealing with the dispatch of one or more of its engineers, technologists to visit the factory site of the assessee, train the factory personnel and to commission the specified processes, would not create a permanent establishment. Therefore, it was held that the payments were not in the nature of 'royalty'. In ***Modern Threads (I) Ltd.*** Vs. ***DCIT***, it was held that the payments were made in installments to Italian company for supply of technical know-how and also for supply of basic process engineering documentation for designing, construction and operation of plant subject to their liability on account of rectifying form, it was held that the amount paid for supply of technical know-how and basic engineering documentation for setting of the plant in India for manufacturing of PTA was the business profit in the hands of Italian company in the absence of permanent establishment in India.

58. In the light of our discussion explaining Explanation 2 to Section 9(1) of the Act, let us proceed to apply these principles on the facts of the case. The starting point has to be the nature of services provided by the appellant to its customers as per the agreement arrived at between them. Keeping in view the aforesaid operation of the satellites, we revert back to the

agreement entered into between the appellant and its customers. It is clear from various clauses of the agreement (and noticed above), the appellant is the operator of the satellites. It also remains in the control of the satellite. It had not leased out the equipments to the customers. On this basis, it is argued by the appellant that the equipment is used by the appellant and it is only providing and rendering services to its customers and not allowing the customers to use the process. In the case of ***ISRO (Supra)***, AAR has narrated in detail the process of the operation of a satellite and the role played by the transponder therein.

59. Following features of the agreement entered into by the appellant with its clients need to be highlighted at this stage:

(a) The appellant is a foreign company incorporated in Hong Kong and carries business of providing satellite business and broadcasting facilities.

(b) The clients with whom the appellant has entered into agreement are not the residents of India.

(c) The appellant has launched its satellites in the orbit footprint on which it is extended over four continents including Asia and, thus, covers India.

(d) The agreement signed with the customers which are TV channels, the appellant provides facility of transponder capacity available on its satellite to enable these TV channels to relay their signals. These customers have their own relaying facilities, which are situated outside India. From this facility, the signals are beamed in space where they are received by a

transponder located in the appellant satellite. Th transponder receives the signal and on account of the distance these signals have to travel, they are required to be amplified. After amplification frequency of signals are downlinked to facilitate the transmission of signals. This is how the signals are received over various parts of the earth spanning numerous countries including India.

(e) The outcome, thus, would entirely depend upon the question as to whether any "process" is used by the TV Channels and also whether a "secret process" is required to bring within the ambit of Explanation 2.

60. Once we keep in mind the aforesaid important aspects, it is not difficult to find the answer to the question posed. In fact, we can say that it is SO provided by the AAR in ***ISRO (supra)***. A close scrutiny of the said ruling of the AAR would clearly reveal that where the operator has entered into an agreement for lease of transponder capacity and has not given any control over parts of satellite/transponder, the provisions of sub-clause (vi) would not apply. In the present case also, the appellant had merely given access to a broadband with available in a transponder which can be utilized for the purpose of transmitting the signals of the customer. In that case, after taking note in depth, the operation and the functioning of transponder, the AAR emphasized on the fact that data sent by the telecast operator does not undergo any change for improvement through the media of transponder.

Following discussion from the said judgment needs to b reproduced:

> "13. As IGL does not carry on any business in India through P.E., as discussed towards the end, the main contention of Revenue is that the 'charges' paid by the applicant – ISRO under the terms of the agreement is in the nature of consideration paid for the 'use of' or 'right to use' the scientific equipment within the meaning of Clause (b) of Article 13(3) of the Treaty.
>
> 14. The crucial question that needs to be addressed, therefore, is whether the payment made to IGL under the aforementioned contract constitutes consideration for the use of or right to use equipment of IGL. To answer this question, we have to discern the substance and essence of the contract as revealed from the terms of the contract document, the technical report and other facts furnished by the applicant. The first Article in the contract makes it clear that the payment is for the "lease of' navigation transponder segment capacity". From the designated transponder (L1 and L5) of Inmarsat satellite, this capacity at a particular frequency is made available to the applicant through INLUS (Navigation Land Uplink Station) which is set up and operated by the applicant. The capacity is meant to be used for the purpose of providing an augmentation to global satellite navigation system. The capacity will be utilized through data commands issued from the ground station(INLUS). Undeniably, the applicant will not be able to operate the transponder in the space but it will be transmitting/ uplinking the augmented data to the navigation transponder. Access to the transponder's space capacity is established through the applicant's operations at the ground station (INLUS) pursuant to which the transponder transmits signals/data received from INLUS from the geo-stationary orbits. **The Inmarsat satellite carries many transponders out of which the transponder for navigation purposes will provide the satellite based augmentation system signals in space at two frequencies i.e.** 1575.42 MHz (L1) and 1176.45 MHz (L5) which are accessed for the GAGAN project undertaken by the applicant. It is also seen that the navigation transponder which uplinks and downlinks the data is a **passive transponder unlike the communication transponder.**
>
> 15. It will be relevant to know the connotation of the term 'transponder'. In Mc Graw Hill's Dictionary of Scientific and Technical Terms, the meaning given is "a transmitter-receiver capable of accepting the challenge of an interrogator and automatically transmitting an appropriate reply". In Chamber's Dictionary of Science and Technology, 'transponder' (communication), is defined as an equipment forming part of a communications satellite, which receives signals from a ground station at one frequency and re-

transmits them to another ground station or to domestic satellite receivers at another frequency".

16. It is clear that the applicant in the course of carrying out its objectives and operations will not be using any equipment of IGL satellite or the transponder. What the applicant needs to do is to adjust or tune its system to access the navigation transponder space segment capacity. By earmarking a space segment capacity of the transponder for use by the applicant, the applicant does not get possession (actual or constructive) or control of the equipment of IGL. The applicant and the end-users are enabled to have the benefit of use of facility provided by Inmarsat 4th generation satellite and the navigational transponder it has. That is the objective of GAGAN Project. The applicant does not use or operate any equipment of IGL. The lease of space segment capacity related to L1 and L5 transponder only means that a segment of the navigational transponder though which the data passes is allocated to the applicant so that it could be utilized for the specific purpose of making available the augmented data sent by the applicant through its ground station to the users extensively. The substance of the contract is the facility given to the applicant for the utilization of space segment capacity of the transponder for transmitting the augmented data as to the position of an object on land, air or water so that the end user can have access to it through SABS receiver. The use of capacity, as clarified by the applicant involves the use of bandwidth, that is to say, a particular bandwidth in the transponder meant exclusively for navigational purposes is linked to the earth station (INLUS). The expression 'use of space segment capacity' of transponder has no reference to any operations performed by means of the transponder. The use or operation of transponder as such is not at all contemplated under the Contract. **What really happens is that the augmented data sent by INLUS reaches the transponder and it is transmitted back to the Earth and the same is accessed by SBAS user receivers in the coverage area. In response to a query, the applicant specifically clarified that the transponder does not perform any operation with reference to the data uplinked and downlinked and "there is no on-board data storage.**"

61. It is worthwhile to note that the contention of the Department that there was use of transponder by the applicant was specifically rejected in the following terms:

"17. It is contended by the Revenue that in substance, there is use of equipment i.e. transponder by the applicant. The exclusive capacity of specific transponder is kept entirely at the disposal of the applicant. The use of

transponder is ensured when it responds to the directions sent through the ground station. Such directions, it is stated, are akin to the operation of TV by remote control apparatus. We find it difficult to accept this contention. The fact that the transponder automatically responds to the data commands sent from the ground station network and retransmits the same data over a wider footprint area covered by Inmarsat satellite does not mean that the control and operation of transponder is with the applicant. Undoubtedly, the applicant does not operate the transponder; it gets access to the navigation transponder through the applicant's own network/apparatus. **The data sent by the applicant does not undergo any change or improvements through the media of transponder.** In essence, it amounts to the provision of a communication/ navigational link through a facility owned by IGL and exclusively operated/controlled by it. The operation and regulation of transponder is always with IGL. **It is also pertinent to notice that a navigation transponder unlike a communication transponder is not an active transponder in the sense it does not amplify. It is a passive transponder, as pointed out by the applicant. This is also a pointer that the applicant does not use the equipment (transponder) as such.**"

62. It is also clear from the above that the aspect of amplification of data by the transponder is taken only as additional factor, but the judgment is not entirely rested on that. This Ruling further categorically demonstrates that in a case like this, services are provided which is integral part of the satellite, remains under the control of the satellite/transponder owner (like the appellant in this case) and it does not vest with the telecast operator/TV channels.

63. Position is substantially the same in the present case as well. The Tribunal has distinguished this judgment and has opined that it is not applicable because of the reason that in ***ISRO (supra)***, there was any amplification of the signal whereas in the present case, signals are amplified. That, to our mind, would not make any difference insofar as ultimate conclusion is concerned, inasmuch as the ruling of the AAR is not founded on the aforesaid consideration. It becomes manifest when we take note of the

question posed by the AAR before answering the same. The AA expressed this as under:

> "The crucial question that needs to be addressed, therefore, is whether the payment made to IGL under the aforementioned contract constitutes consideration for the use of or right to use equipment of IGL. To answer this question, we have to discern the substance and essence of the contract as revealed from the terms of the contract document, the technical report and other facts furnished by the applicant. "

64. On the aforesaid poser, the AAR discussed the issue and held that the transponder and the process therein are actually utilized for the satellite use3r for rendering the services to the customer and further that it cannot be said that the transponder or process employed therein are used by the customer.

65. It needs to be emphasized that a satellite is not a mere carrier, nor is the transponder something which is distinct and separable from the satellite as such. It was explained that the transponder is in fact an inseverable part of the satellite and cannot function without the continuous support of various systems and components of the satellite, including in particular:

(a) Electrical Power Generation by solar arrays and Storage Battery of the satellite, which is common to and supports multiple transponders on board the satellite.

(b) Common input antenna for receiving signals from the customers' ground stations, which are shared by multiple transponders.

(c) Common output antenna for retransmitting signals back to the footprint area on earth, which are shared by multiple transponders.

(d) Satellite positioning system, including positio adjusting thrusters and the fuel storage and supply system therefor in the satellite. It is this positioning system which ensures that the location and the angle of the satellite is such that it receives input signals properly and retransmits the same to the exact desired footprint area.

(e) Temperature control system in the satellite, i.e., heaters to ensure that the electronic components do not cease to operate in conditions of extreme cold, when the satellite is in the "shadow".

(f) Telemetry, tracking and control system for the purpose of ensuring that all the above mentioned systems are monitored and their operations duly controlled and appropriate adjustments made, as and when required.

66. It was also not disputed that each transponder requires continuous and sustained support of each of the above-mentioned systems of the satellite without which it simply cannot function. Consequently, it is entirely wrong to assume that a transponder is a self-contained operating unit, the control and constructive possession of which is or can be handed over by the satellite operator to its customers. On the contrary, the transponder is incapable of functioning on its own. In fact, the Tribunal has itself demonstrated so in the order as is clear from the following:

> "A bare perusal of this meaning reveals that equipment is an instrument or tool which is capable of doing some job independently or with the help of other tools. A part of a equipment incapable of performing any activity in itself

cannot be termed as an equipment. We take an example of scissors which has two blades. This scissor is n equipment but when one blade is separated from the other blade, it ceases to be an equipment. In other words, the blade in isolation cannot be termed as an equipment. Reverting to the facts of the present case, we find that the transponder is not an equipment in itself On other words, it is not capable of performing any activity when divorced from the satellite. It was fairly conceded by the Ld. AR that the transponder in itself without other parts of satellite is not capable of performing any function. Rightly so because satellite is not plotted at a fixed place. It rotates in the same direction and speed as the earth. If it had been fixed at a particular place or the speed or direction had been different from that of earth, it could not have produced the desired results. Transponder is part of satellite, which is fixed in the satellite and is neither moving in itself nor assisting the satellite to and the transponder, namely, a part of it, playing howsoever important role, cannot be termed as equipment."

67. Even after stating so, the Tribunal did not take the aforesaid view to its logical conclusion, viz., the process carried on in the transponder in receiving signals and retransmitting the same, is an inseparable part of the process of the satellite and that process is utilized only by the appellant who is in control thereof. Whether it is done with or without amplification of the signal would not make any difference, in such a scenario.

68. We are inclined to agree with the argument of the learned Senior counsel for the appellant that in the present case, control of the satellite or the transponder always remains with the appellant. We may also observe at this stage that the terms "lease of transponder capacity", "lessor", "lessee" and "rental" used in the agreement would not be the determinative factors. It is the substance of the agreement which is to be seen. When we go through the various clauses of the said agreement, it becomes clear that the control always remained with the appellant and the appellant had merely given access to a broadband available with the transponder, to particular customers. We may also point out

that against the decision of the AAR in ***ISRO (supra)*** case, Specia Leave Petition was dismissed by the Supreme Court (see ***Puran Singh Sahni*** Vs. ***Sundari Bhagwandas Kripalani & Ors.,*** **(1991) 2 SCC 180**).

69. We may also refer to the following distinction brought out by the Karnataka High Court between leasing out of equipment and the use of equipment by its customer. This was done in the case of ***Lakshmi Audio Visual Inc.*** Vs. ***Asstt. Commissioner of Commercial Taxes (Kar.)*** **[124 STC 426]** in the following terms:

> "9. Thus if the transaction is one of leasing/hiring/letting simpliciter under which the possession of the goods, i.e., effective and general control of the goods is to be given to the customer and the customer has the freedom and choice of selecting the manner, time and nature of use and enjoyment, though within the frame work of the agreement, then it would be a transfer of the right to use the goods and fall under the extended definition of "sale". On the other hand, if the customer entrusts to the assessee the work of achieving a certain desired result and that involves the use of goods belonging to the assessee and rendering of several other services and the goods used by the assessee to achieve the desired result continue to be in the effective and general control of the assessee, then, the transaction will not be a transfer of the right to use goods falling within the extended definition of "sale". Let me now clarify the position further, with an illustration which is a variation of the illustration used by the Andhra Pradesh High Court in the case of Rashtriya Ispat Nigam Ltd. v. Commercial Tax Officer.
>
> Illustration :
>
> (f) A customer engages a carrier (transport operator) to transport one consignment (a full lorry load) from place A to B, for an agreed consideration which is called freight charges or lorry hire. The carrier sends its lorry to the customer's depot, picks up the consignment and proceeds to the destination for delivery of the consignment. The lorry is used exclusively for the customer's consignment from the time of loading, to the time of unloading at destination. Can it be said that right to use of the lorry has been transferred by the carrier to the customer ? The answer is obviously in the negative, as there is no transfer of the "use of the lorry" for the following reasons : (i) The lorry is never in the control, let alone effective control of the

customer ; (ii) the carrier decides how, when and where the lorry moves to the destination, and continues to be in effective control of the lorry ; (hi) the carrier can at any point (of time or place) transfer the consignment in the lorry to another lorry ; or the carrier may unload the consignment en-route in any of his godowns, to be picked up later by some other lorry assigned by the carrier for further transportation and delivery at destination.

(ii) On the other hand, let us consider the case of a customer (say a factory) entering into a contract with the transport operator, under which the transport operator has to provide a lorry to the customer, between the hours 8.00 a.m. to 8.00 p.m. at the customer's factory for its use, at a fixed hire per day or hire per km subject to an assured minimum, for a period of one month or one week or even one day ; and under the contract, the transport operator is responsible for making repairs apart from providing a driver to drive the lorry and filling the vehicle with diesel for running the lorry. The transaction involves an identified vehicle belonging to the transport operator being delivered to the customer and the customer is given the exclusive and effective control of the vehicle to be used in any manner as it deems fit ; and during the period when the lorry is with the customer, the transport operator has no control over it. The transport operator renders no other service to the customer. Therefore, the transaction involves transfer of right to use the lorry and thus be a deemed sale."

70. Argument was addressed on the meaning which is assigned to the term "royalty" occurring in sub-clause (iii) of Explanation 2. The learned counsel for the appellant had argued that the doctrine of *niscitur a sociis* would apply and the process should be treated as item of intellectual property. On this it was argued that the process employed in the transponder of a satellite, i.e., changing of frequency and amplifying the signal, is not at all an item of intellectual property. Though there appears to be some force in this argument, it is not necessary to answer it conclusively. The fact remains that there is no use of 'process' by the TV channels. Moreover, no such purported use has taken

place in India. It is stated at the cost of repetition that the telecast companies/customers are situated outside India and so is the appellant. Even the agreements are executed abroad under which the services are provided by the appellant to its customers. The transponder is in the orbit. Merely because it has its footprint on various continents would not mean that the process has taken place in India. This aspect now stands concluded by the Supreme Court in the case of ***Ishikawaima-Harima Heavy Industries Ltd.*** (***supra***). In that case, the appellant, a non-resident company incorporated in Japan, along with five other enterprises formed a consortium. The consortium was awarded by Petronet a turnkey project for setting up a liquefied natural gas (LNG) receiving, storage and regasification facility in Gujarat. The contract specified the role and responsibility of each member of the consortium and the consideration to be paid separately for the respective work of each member. The appellant was to develop, design, engineer, procure equipment, materials and supplies to erect and construct storage tanks including marine facility (jetty and island breakwater) for transmission and supply of LNG to purchasers, to test and commission the facilities, etc. The contract involved : (i) offshore supply, (ii) offshore services, (iii) onshore supply, (iv) onshore services and (v) construction and erection. The price for offshore supply and offshore services was payable in US dollars, that for onshore supply and onshore services and construction and erection partly in US dollars and partly in Indian rupees. The payment for offshore supply of equipment and materials supplied from outside India was

received by the appellant by credit to a bank account in Tokyo and the property in the goods passed to Petronet on the high seas outside India. Though the appellant unloaded the goods, cleared them from Customs and transported them to the site, it was for and on behalf of Petronet and the expenditure including the customs duty was reimbursed to it. The price of offshore services for design and engineering including detailed engineering in relation to the supplies, services and construction and erection and the cost of any other services to be rendered from outside India, was also paid in US dollars in Tokyo. On these facts the appellant applied to the Authority for Advance Rulings (Income Tax) for a ruling on the following points:

(a) Whether the amounts received/receivable by the appellant from Petronet for offshore supply of equipment, materials, etc., were liable to tax in India under the provisions of the Income tax Act, 1961, and the Double Taxation Avoidance Convention between Indian and Japan;

(b) Whether the amounts received/receivable form Petronet for offshore services were chargeable to tax in India under the Act and the Convention; and

(c) Would the appellant be able to claim deduction for expenses incurred in computing the income from offshore services.

The Authority ruled:

(i) That though property in the goods passed to Petronet while the goods were on the high seas, and insofar as

the activities of the appellant for taking delivery of the goods from the ship, payment of customs duty and transportation of the goods to the site were concerned, these facts did not militate against the property in the goods passing to the appellant. In connection with the offshore supply, certain operations were inextricably interlinked in India, such as, signing of the contract in India which imposed liability on the appellant to procure equipment and machinery in India and receiving, unloading, storing and transporting, paying demurrage and other incidental charges on account of delay in clearance. The price of the goods covered not only their price but also of all these operations which were carried out in India and from which income accrued to the appellant. Therefore, income accrued to the appellant from the offshore supply through business connection in India and some operations of the business were carried out in India. Profits were deemed to accrue/arise in India would be only such part of the profits as was reasonably attributable to the operation carried out in India.

(ii) That having regard to Article 7(1) of the Convention For Avoidance of Double taxation and Fiscal Evasion with respect to Taxes on Income between India and Japan read with paragraph 6 of the Protocol supply of equipment or machinery (sale of which was completed around, the order having been placed directly by the

overseas office of the enterprise) would be within the meaning of the phrase "directly or indirectly attributable to that permanent establishment" and, therefore, so much of the amount received or receivable by the appellant as was directly or indirectly attributable to the permanent establishment as postulated in paragraph 6 of the Protocol would be taxable in India. The price of the offshore services would be deemed to accrue or arise under Section 9(1)(vii) of the Income Tax Act, 1961. And inasmuch as fees for technical services were specifically provided in Article 12 of the Convention, they would not fall under Article 7. Therefore, the price of the offshore services was taxable in India under the Act as well as the Convention.

(iii) That, however, in view of Section 115A(1)(b)(B) of the Act and Article 12(2) of the Convention, tax was payable at the fixed rate of 20 per cent of the gross amount of fees for technical services and the applicant would not be able to claim any deduction from the amount.

71. In that case, the appellant approached the Supreme Court challenging the aforesaid judgment of the AAR. The Supreme Court reversed the decision of the AAR and in the process, *inter alia,* held as under:

> "(i) That Section 9 of the Income tax Act, 1961, raises a legal fiction; but, having regard to the contextual interpretation and in view of the fact that the court is dealing with a taxation stature, the legal fiction must be construed having regard to the object it seeks to achieve. The legal fiction created under Section 9 must also be read having regard to the other provisions thereof.

(ii) That the second sentence of Article 7(1) which allowed the State of the permanent establishment to tax business profits, but only so much of them as was attributable to the permanent establishment excluded the applicability of the principle that where there was a permanent establishment, the State of the permanent establishment should be allowed to tax all income derived by the enterprise from sources in the State irrespective of whether or not such income was economically connected with the permanent establishment. **The State of the permanent establishment was allowed to tax only those profits which were economically attributable to the permanent establishment, i.e., those which resulted from the permanent establishment's activities, which were economically from the business carried on by the permanent establishment.** In this case, the permanent establishment's non-involvement in the transaction of offshore supply, excluded it from being a part of the cause of the income itself and thus there was no business connection.

(iii) **That for attracting the tax there had to be some activities through the permanent establishment. If income arose without any activity of the permanent establishment, even under the Convention the taxation liability in respect of overseas services would not arise in India.** Section 9 spelled out the extent to which the income of a non-resident would be liable to tax in India. Section 9 had a direct territorial nexus. Relief under a Double Taxation Avoidance Treaty, having regard to the provisions contained in Section 90(2), would arise only in the event taxable income of the assessee arose in one Contracting State on the basis of accrual of income in another Contracting State on the basis of resident. So far as accrual of income in India was concerned, taxability must be read in terms of Section 4(2) read with Section 9, whereupon the question of seeking assessment of such income in India on the basis of the Double Taxation Treaty would arise. Paragraph 6 of the Protocol to the Convention was not applicable, because, for the profits to be "attributable directly or indirectly", the permanent establishment must be involved in the activity giving rise to the profits.

(iv) That where different severable parts of a composite contract were performed in different places, as in this case, the principle of apportionment could be applied to determine which fiscal jurisdiction could tax that particular part of the transaction. This principle helped determine where the territorial jurisdiction of a particular State lay and to determine its capacity to tax on event. Applying it to composite transactions which had some operations in one territory and some in the other, was essential to determine the taxability of various operations. **The**

concepts of profits of business connection was relevant for the purpose of application of Section 9, the concept of permanent establishment was relevant for assessing the income of a non-resident under the Convention.

(v) **That in this case the entire transaction was completed on the high seas and, therefore, the profits on sale did not arise in India. Once excluded from the scope of taxation under the Income – tax Act application of the Double Taxation Avoidance Treaty would not arise.**

(vi) That, in relation to offshore services, Section 9(1)(vii)(c) required two conditions to be met: to be taxable in India the services which were the source for the income sought to be taxed had to be rendered in India as well as utilized in India.

(vii) That whatever was payable by a resident to a non-resident by way of technical fees would not always come within the purview of Section 9(1)(vii). It must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax.

(viii) That even in relation to such income, viz., income from offshore services, the provisions of Article 7 of the Convention would be applicable, as **services rendered outside India would have nothing to do with the permanent establishment in India.** Thus, if any services had been rendered by the head office of the appellant outside India, only because they were connected with the permanent establishment, even in relation to the principle of apportionment would apply." (***emphasis supplied***)

72. The Tribunal has made an attempt to trace the fund flow and observed that since the end consumers, i.e., persons watching TV in India are paying the amounts to the cable operators who in turn are paying the same to the TV channels, the flow of fund is traced to India. That is a far-fetched ground to rope in the appellant in the taxation net. The Tribunal has glossed over an important fact that the money which is received from the cable operators by the telecast operators is treated as income by these telecast operators which has accrued in India and they have offered and paid tax.

Thus, the income which is generated in India has been dul subjected to tax in India. It is the payment which is made by the telecast operators who are situated abroad to the appellant which is also a non-resident, i.e., sought to be brought within the tax net.

73. For the aforesaid reasons, it is difficult to accept such far-fetched reasoning with no causal connection.

74. Even when we look into the matter from the standpoint of "Double Taxation Avoidance Agreement (DTAA)", the case of the appellant gets boost. The Organisation of Economic Cooperation and Development (OECD) has framed a model of "Double Taxation Avoidance Agreement (DTAA)" entered into by India are based. Article 12 of the said model DTAA contains a definition of "royalty" which is in all material respects virtually the same as the definition of "royalty" contained in clause (iii) of Explanation 2 to Section 9(1) (vi) of the Act. This fact is also not in dispute. The learned counsel for the appellant had relied upon the commentary issued by the OECD on the aforesaid model DTAA and particularly, referred to the following amendment proposed by OECD to its commentary on Article 12, which reads as under:

> "9.1 Satellite operators and their customers (including broadcasting and telecommunication enterprises) frequently enter into "transponder leasing" agreements under which the satellite operator allows the customer to utilize the capacity of a satellite transponder to transmit over large geographical areas. Payments made by customers under typical "transponder leasing" agreements are made for the use of the transponder transmitting capacity and will not constitute royalties under the definition of paragraph 2; these payments are not made in consideration for the use of, or right to use, property, or for information, that is referred to in the definition (they cannot be viewed, for instance, as payments for information or for the use of, or right to use, a secret process since the satellite technology is not transferred to the customer). As regards treaties that include the leasing of industrial, commercial or scientific (ICS) equipment in the definition of

> royalties, the characterization of the payment will depend to a large extent on the relevant contractual arrangements. Whilst the relevant contracts often refer to the "lease" of a transponder, in most cases the customer does not acquire the physical possession of the transponder but simply its transmission capacity: the satellite is operated by the lessor and the lessee has no access to the transponder that has been assigned to it. In such cases, the payments made by the customers would therefore be in the nature of payments for services, to which Article 7 applies, rather than payments for the use, or right to use, ICS equipment. A different, but much less frequent, transaction would be where the owner of the satellite leases it to another party so that the latter may operate it and either use it for its own purposes or offer its data transmission capacity to third parties. In such a case, the payment made by the satellite operator to the satellite owner could well be considered as a payment for the leasing of industrial, commercial or scientific equipment. Similar considerations apply to payments made to lease or purchase the capacity of cables for the transmission of electrical power or communities (e.g. through a contract granting an indefeasible right of use of such capacity) or pipelines (e.g. for the transportation of gas or oil)."

75. Much reliance was placed upon the commentary written by Klaus Vogel on 'Double Taxation Conventions (3rd Edition)'. It is recorded therein:

> "The use of a satellite is a service, not a rental (thus correctly, Rabe, A., 38 RIW 135 (1992), on Germany's DTC with Luxembourg); this would not be the case only in the event the entire direction and control over the satellite, such as its piloting or steering, etc. were transferred to the user. "

76. Klaus Vogel has also made a distinction between "letting an asset" and "use of the asset by the owner for providing services" as below:

> "On the other hand, another distinction to be made is letting the proprietary right, experience, etc., on the one hand and use of it by the licensor himself, e.g., within the framework of an advisory activity. Within the range from 'services', viz. outright transfer of the asset involved (right, etc.) to the payer of the royalty. The other, just as clear-cut extreme is the exercise by the payee of activities in the service of the payer, activities for which the payee uses his own proprietary rights, know-how, etc., while not letting or transferring them to the payer."

77. The Tribunal has discarded the aforesaid commentary of OECD a well as Klaus Vogel only on the ground that it is not safe to rely upon the same. However, what is ignored is that when the technical terms used in the DTAA are the same which appear in Section 9(1)(vi), for better understanding all these very terms, OECD commentary can always be relied upon. The Apex Court has emphasized so in number of judgments clearly holding that the well-settled internationally accepted meaning and interpretation placed on identical or similar terms employed in various DTAAs should be followed by the Courts in India when it comes to construing similar terms occurring in the Indian Income Tax Act. We may reproduce the following passage from the judgment of the Court in the case of ***Union of India and Another*** Vs. ***Azadi Bachao Andolan and Another,*** **[(2003) 263 ITR 706]** in the following words:

> **85.** In our view, the contention of the respondents proceeds on the fallacious premise that liability to taxation is the same as payment of tax. Liability to taxation is a legal situation; payment of tax is a fiscal fact. For the purpose of application of Article 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax. If this were not so, the DTAC would not have used the words liable to taxation, but would have used some appropriate words like pays tax. On the language of the DTAC, it is not possible to accept the contention of the respondents that offshore companies incorporated and registered under MOBA are not liable to taxation under the Mauritius Income Tax Act; nor is it possible to accept the contention that such companies would not be resident in Mauritius within the meaning of Article 3 read with Article 4 of the DTAC.
>
> **86.** There is a further reason in support of our view. The expression liable to taxation has been adopted from the Organisation for Economic Co-operation and Development Council (OECD) Model Convention 1977. The OECD commentary on article 4, defining resident, says : "Conventions for the avoidance of double taxation do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which

a person is to be treated fiscally as "resident" and, consequently, is fully liable to tax in that State". The expression used is liable to tax therein, by reasons of various factors. This definition has been carried over even in Article 4 dealing with resident in the OECD Model Convention 1992.

87. In A Manual on the OECD Model Tax Convention on Income and On Capital, at paragraph 4B.05, while commenting on Article 4 of the OECD Double Tax Convention, Philip Baker points out that the phrase liable to tax used in the first sentence of Article 4.1 of the Model Convention has raised a number of issues, and observes :

> "It seems clear that a person does not have to be actually paying tax to be "liable to tax" otherwise a person who had deductible losses or allowances, which reduced his tax bill to zero would find himself unable to enjoy the benefits of the convention. It also seems clear that a person who would otherwise be subject to comprehensive taxing but who enjoys a specific exemption from tax is nevertheless liable to tax, if the exemption were repealed, or the person no longer qualified for the exemption, the person would be liable to comprehensive taxation."

78. There are judgments of other High Courts also to the same effect. These are as under:

(a) ***Commissioner of Income Tax*** Vs. ***Ahmedabad Manufacturing and Calico Printing Co.,*** **[139 ITR 806 (Guj.)]** at Pages 820-822.

(b) ***Commissioner of Income Tax*** Vs. ***Vishakhapatnam Port Trust*** **[(1983) 144 ITR 146 (AP)]** at pages 156-157.

(c) ***N.V. Philips*** Vs. ***Commissioner of Income Tax*** **[172 ITR 521]** at pages 527 & 538-539.

79. For the aforesaid reasons, we are unable to subscribe to the view taken by the Tribunal in the impugned judgment on the interpretation of Section 9(1) (vi) of the Act. We, thus, answer

Question No. (3) in favour of the assessee and against th Revenue and set aside the order of the Tribunal on this aspect.

Re: Applicability of Section 9(1)(vii):

80. It was for the first time that the Revenue argued before the Tribunal that income of the appellant was taxable under Section 9(1)(vii) of the Act as well. The appellant had objected to the admission of this ground. The Tribunal brushed aside this objection and admitted the ground. At the same time, the Tribunal did not decide the issue as the income of the assessee is held taxable under Section 9(1)(vi) of the Act. It is for this reason both the assessee and the Revenue have challenged the order of the Tribunal whereas the appellant states that the Tribunal erred in admitting this ground, the Revenue pleads that the Tribunal erred in not deciding the issue even after admission. Insofar as the objection of the appellant is concerned, we are of the opinion that it has no merit. The Tribunal rightly held that the issue raised was purely legal, which did not require consideration of any fresh facts, as all necessary facts were adjudication of the issue as to whether the amount received was chargeable to tax under Section 9(1)(vii) were available on record. Insofar as the issue on merit is concerned, interestingly no arguments were advanced by the learned counsel for the Revenue. The ground was admitted at the instance of the Revenue. Further specifically, question of law was raised and appeal admitted on that ground as to whether the Tribunal erred in law in not deciding the issue. In spite thereof, during arguments, this aspect on merits was not touched, therefore, we cannot accept the submission of the Revenue for

covering the case under Section 9(1)(vii) of the Act. Presuming form the aforesaid conduct, the case is not sought to be covered under this Section.

81. As a result, the appeal preferred by the assessee is allowed and the judgment of the Tribunal is set aside and the appeal of the Revenue is dismissed.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

JANUARY 31, 2011
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