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

Reserved on: 30.11.2015
Pronounced on: 08.02.2016

\+ **ITA 473/2012**

DIRECTOR OF INCOME TAX …….Appellant

Versus

NEW SKIES SATELLITE BV ……Respondent

\+ **ITA 474/2012**

DIRECTOR OF INCOME TAX …….Appellant

Versus

NEW SKIES SATELLITE BV ……Respondent

\+ **ITA 500/2012**

DIRECTOR OF INCOME TAX …….Appellant

Versus

SHIN SATELLITE PUBLIC CO. LTD. ……Respondent

\+ **ITA 244/2014, C.M. APPL.9724/2014**

DIRECTOR OF INCOME TAX-II …….Appellant

Versus

SHIN SATELLITE PUBLIC CO. LTD. ……Respondent

Through: Sh. Rohit Madan, Sh. Ruchir Bhatia and Sh. Akash Vajpai, Advocates, for DIT in ITA

244/2014, ITA 473/2012, ITA 474/2012 & ITA 500/2012
Sh. M.S. Syali, Sr. Advocate with Sh. Mayank Nagi and Ms. Bhawna Bakshi, Advocates, for respondent in ITA 473/2012 and ITA 474/2012.
Sh. T.V.S. Raghavendra Sreyas and Sh. N. Sai Vinod, Advocates, for respondent in ITA 474/2012.
Sh. F.V. Irani, Sh. Nikhil Nayyar, Sh. Arun. H. Mehta and Ms. Akansha, Advocates, for respondent in ITA 500/2012.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT

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1. The present appeals, by the Revenue, under Section 260A of the Income Tax Act 1961 ("the Act") are preferred against orders of the Income Tax Appellate Tribunal ("ITAT"), which upset Assessment Orders that ruled that the income derived by the assessees through data transmission services was taxable as royalty under Section 9(1)(vi) of the Act as well as Article 12 of the relevant Double Tax Avoidance Agreements ("DTAA"). The ITAT however, in the light of the judgment in *Asia Satellite Communications Co. Ltd. V. Director of Income Tax*[1], interpreting Section 9(1)(vi) in the context of such services, reversed the said orders. During the pendency of these appeals, the Finance Act of 2012 amended Section 9(1)(vi) and inserted Explanations 4, 5, and 6.

2. The substantial question framed by this Court is two-fold;

[1] [2011] 332 ITR 340 (Del)

(1) whether the receipts of the assessees earned from providing data transmission services, fall within the term royalty under the Income Tax Act, 1961, and

(2) if the answer to the first is in the affirmative, whether the assessees would be eligible for the benefit under the relevant Double Tax Avoidance Agreements.

3. In the interest of both brevity and clarity, below is a table of details with respect to the assessment orders and the orders of the ITAT:

ITA No.	*Parties*	*Assessment Year*	*Date of Assessment Order*	*Applicable Treaty*
ITA 500/2012	*DIT v. Shin Satellite*	*2007-08*	*30.09.2010*	*Indo Thai DTAA*
ITA 244/2014	*DIT v. Shin Satellite*	*2009-10*	*09.04.2012*	*Indo Thai DTAA*
ITA 473/2012	*DIT v. New Skies*	*2008-09*	*17.08.2011*	*Indo Netherlands DTAA*
ITA 474/2012	*DIT v. New Skies*	*2006-07*	*17.08.2011*	*Indo Netherlands DTAA*

Brief Facts: Pre-Finance Act 2012

4. The assessee in ITA 500/12 and 244/14, M/s Shin Satellite Public Co. Ltd. (hereafter "Shin"), is a company incorporated in Thailand, engaged in the business of providing digital broadcasting services as well as

consultancy services to its customers who consist of both residents of India and non-residents. Shin provides these services through its satellite Thaicom 3, whose footprint covers a large geographical area, including India. In AY 2007-08 and 2009-10, the assessee filed NIL returns. The AO reviewed the return under Section 143(3) read with Section 144C of the Act and held that the income was taxable under Explanation 2(iii) and (iva) of Section 9(1)(vi) of the Act as well as Article 12 of the Indo-Thai DTAA.

5. Likewise, the assessee in ITA 473/2014 and 474/2012 is a company incorporated in Netherlands, namely M/s New Skies Satellite B.V. (hereafter "New Skies") that engages in providing digital broadcasting services. On filing a return of NIL taxable income for the relevant years, the AO again under Section 143(3) r/w 144C applied Section 9(1)(vi) of the Act to tax the income of the assessee as royalty.

6. The assessees in the present cases both derive income from the "lease of transponders" of their respective satellites. This lease is for the object of relaying signals of their customers; both resident and non-resident TV channels that wish to broadcast their programs for a particular audience situated in a particular part of the world. In the present cases, the assessees were chosen for the simple reason that the footprint of their satellites, i.e. the area over which the satellite can transmit its signal, includes India. The process by which the TV programmes reach the viewers in India can be simply described. The TV channels produce or acquire the tapes of the programs, which they then uplink to the satellite. The satellite then receives the content, amplifies it, changes its frequency by undertaking certain processes, and then downlinks it, scattering the signal over the area of its

footprint. The cable operators who ultimately relay it to the viewers in their homes then receive the downlinked signal.

7. These satellites are geostationary satellites placed in an orbit 22240 miles above the surface of the Earth. The repeater section of the satellites contains antenna systems and microwave electronics that receive, amplify, modify (in frequency and in polarization) and retransmit the signals received by it. This antenna section has two reflectors, one for receiving and the other, for transmitting. The path of each channel between the receiving antennae to transmitting antennae is called the transponder. The transponder is used to amplify and shift the frequency of each signal. The uplinked signal emanates from the uplink earth station and enters the repeater through the receiving antenna. This antenna on the satellite transforms the wireless (electromagnetic) signals into an electrical form suitable for amplification in the Low Noise Receiver (LNR). The signals are modified within the LNR in frequency to correspond to the relay range and then amplified again before the individual filters. A microwave type boosts the power of the signal within each transponder to a high power level such as 100 Watts before applying it to the transmitting antenna. The latter transforms the electrical signal from all the transponders into an equivalent electromagnetic form for radiation into the footprint where the receiving terminals are located.

8. This is the service the assessees provide to their customers, the income from which is sought to be taxed under Section 9(1)(vi) of the Act. This section has however, since the time of the first assessment order in this case, undergone an amendment. Section 9(1)(vi) as it existed then, and on the basis of which the Assessment Orders were made reads as follows:

"Income deemed to accrue or arise in India.

9. *(1) The following incomes shall be deemed to accrue or arise 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 1.—For the purposes of the first proviso, an agreement made on or after the 1st day of April, 1976, shall be *deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date; so, however, that, where the recipient of the income by way of royalty is a foreign company, the agreement shall not be deemed to have been made before that date unless, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139 (whether fixed originally or on extension) for furnishing the return of income for the assessment year commencing on the 1st day of April, 1977, or the assessment year in respect of which such income first becomes chargeable to tax under this Act, whichever assessment year is later, the company exercises an option by furnishing a declaration in writing to the Assessing Officer (such option being final for that assessment year and for every subsequent assessment year) that the agreement may be regarded as an agreement made before the 1st day of April, 1976.*

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—
(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 ;
(ii) 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 ;
(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;
(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;
(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;
(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with

television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or
(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

9. In ITA 500/2012 the assessee, Shin had on 30.10.2007 filed a NIL return of income, which was processed under Section 143(1) on 26.03.2009. In the previous year, the receipts accrued and arising in India to the assessee had been treated as "royalty". Consequently, the assessee was asked to show cause why the receipts may not be treated as royalty and taxed accordingly as had been done in the past. By its letters dated 03.09.2009 and 16.11.2009, the assessee submitted that the previous treatment of the income as royalty was in fact, erroneous. The income from the services it provided, the assessee asserted, were business profits, which in the absence of a permanent establishment in India, are not subject to tax in India as per Article 7 of the Indo Thai DTAA. Further, it was submitted, that the relevant receipts did not partake the character of royalty. The assessee further quoted the decision of the ITAT in *M/s. Pan AmSat International Systems Inc. v. DCIT, NR Circle, New Delhi*[2] where in the context of similar facts it was held that income of such nature is not liable to tax in India. The assessee also cited the ruling of the Advance Ruling Authority in the case of *ISRO Satellite Centre V. DIT*[3] where it was held that payment by an Indian resident to a foreign company, for utilization of transponder centered on a satellite, is not in the nature of royalty in terms of the provisions of the Act

[2] ITA No. 1796/(Del)/2001
[3] [2008] 307 ITR 59

or the DTAA (in that case with the UK); and in the absence of a permanent establishment in the territory of India not taxable as business profits either.

10. The AO recognised that the operative words in the definition would be *"use"* and *"process"*. First, as regards the word *"process"*, the AO held that the series of acts undertaken within the transponder are done to achieve a particular result, i.e. to make the signals viewable, and this clearly qualifies as a *"process",* the consideration for the *"use"* of which would amount to royalty. Noting the nature of the services provided by the assessee, (as recounted above), the AO observed that the agreements signed by it with its various customers showed that the agreements were not for the purpose of satellite hiring, but for the purpose of providing digital channel services. After enumerating certain clauses of the agreement, the AO held that it was evident that the assessee was providing complete digital broadcasting services right from receiving the signals from its customers, to encoding the signals, feeding them into the uplinking system and to then transmitting these to the required space segment and that this constituted the "process" required to bring the income under the fold of Section 9(1)(vi). He further distinguished the case from the the decision rendered in *PanAmSat*[4]. In that case, the only activity carried out was the processing of the telecasting signal, whereas here, the assessee carried out a number of critical processes required for satellite television broadcast and satellite internet service. Thus, the AO held, that the assessee is receiving payments from its customers for the "use" as well as the right to use a "process" and not for hiring the transponder. Consequently it was held that the assessee's receipts

[4] supra note 2

were squarely covered by sub clause (iii) of Explanation 2 to Section 9(1)(vi) which states as follows:

> *"(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property"*

11. It is also important to note that the AO construed the word *"process"* in Section 9(1)(vi) of the Act, and held that the word *"secret"* qualifies only the term *"formula"* and not process. Resultantly, it would suffice that for the consideration to be termed as royalty, it need only be paid for the use of a process and not a secret process. In any case, the AO also held that the process utilized in the present case would qualify as a secret process. The AO, in doing so, was referring to the transponder as an in-severable part of the satellite itself. Though the agreement states that the lease is that of the transponder capacity, in essence, the required roles cannot be performed without the other essential components of the satellite. In other words, the use of the transponder necessarily means use of the satellite. To support this, the AO referred to the price paid by the customer to the assessee and states that this is disproportionately high in comparison to the cost incurred by the assessee for the transponder. This according to the AO lead to an inference that the customers are compensating the assessee for not only the transponder cost but also the cost of the satellite. The AO did this in an attempt to establish that the secret process therefore being used is the secret process of the satellite itself. He stated that while it may be argued that the theoretical aspects of satellite technology may be available to the interested off the shelves, the finer practical aspects and critical technologies are kept a secret. It is important to note that the AO in fact does quote the commentary of *Klaus Vogel* where secret formula or process has been defined as one

which enjoys *"at least a relative protection or is capable of being protected".* It was also held that similar to sub clause (iva) of Explanation 2, the receipt would also be royalty under Article 12 for the "use of, or right to use industrial, commercial or scientific equipment".

12. Second, on the question of whether the royalty received by a non-resident Telecasting Company is taxable, the AO held that the same would be taxable only if it had been paid in respect of services utilized for the purposes of making or earning any income from any source in India. The source, the AO argues, are the Indian audience, for whom the programs are created, and thus India becomes the territory of commercial exploitation by these non-resident Telecasting Companies. Placing reliance on an *AAR Ruling in Steffen, Robertson and Kirsten Consulting Engineers and Scientists v. CIT*[5], the AO stated that it had been held that for determining the place of accrual the important consideration is not the place where the services for which the payment are being made, but the place where the services are actually utilized. As a result, the AO held that the receipts from non resident and non-resident customers were taxable as royalty both under the Act as well as the Indo Thai DTAA.

13. Having held the receipts as taxable under Section 9(1)(vi) of the Act, the AO also held that the assessees would not get the benefit of the Indo Thai DTAA.

14. Briefly, Article 12 of the Treaty states that royalties, which arise in one of the Contracting States and are payable to a resident of the other Contracting State, may be taxed in that other State. In other words, the general rule is that the Resident State has the right to tax royalties

[5] [1998] 230 ITR 206 AAR

irrespective of the fact that they arise in the Source State. However, the Source State may also choose to tax to a ceratin limit, that limit not exceeding 15 percent of the gross amount of royalties. Royalties as used in Article 12 is defined as:

> *"The term "royalties" as used in this article means payments of any kind received as a consideration for the alienation or the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, phonographic records, and films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of or the right to use industrial, commercial or scientific equipment or for information concerning industrial, commericial or scientific experience."*

Since the AO was of the opinion that the definitions were *pari materia*, he extended his interpretation of "royalty" under Section 9(1)(vi) to Article 12 under the DTAA.

15. By order-dated 22.07.2011, the ITAT set aside the Assessment Order. By this time the judgment of this Court in *Asia Satellite Telecommunication Company Ltd.*[6]. The ITAT held that the facts of the case were now squarely covered by the said judgment. The Court in that case held that the receipts earned from providing data transmission services through the provision of space segment capacity on satellites do not constitute royalty within the meaning of Section 9(1)(vi) of the Act. The Court held that while providing transmission services to its customers, the *control* of the satellite always remains with the satellite operator and the customers are only given access to the transponder capacity. The customer does not therefore use the satellite or the process of the satellite itself. Since that is the case, the payment

6 supra note 1

cannot then be termed as royalty for the use of a process or equipment. Resultantly, the ITAT allowed the appeal of the assessee. It would be wise to remember that the judgment in *Asia Satellite*[7] was solely in the context of Section 9(1)(vi) of the Act, there being no Double Tax avoidance Agreement in that factual matrix.

16. ITA 244/2014, also in the case of assessee Shin, was preferred by the Revenue against the order of the ITAT applying the judgment of *Asia Satellite*[8]. Here too the ITAT had overturned the Assessment Order dated 09.04.2012. The order was similar if not wholly identical to the one passed in ITA 500/2012.

17. ITA 473/2012 and 474/2012 are filed by the Revenue against the order of the ITAT overturning common assessment order dated 17.08.2011, in the case of assessee New Skies. Here the return of income for the AY 2008-09 was filed on 10.10.2008 declaring NIL income. For the same reasons as above, the AO held the income taxable under Section 9(1)(vi). However, in addition to this, the AO also went into the difference between the definition of royalty under Section 9(1)(vi) and the treaty, in that case, the Indo-Netherlands DTAA. Here, the definition of royalty under Article 12(4) is as follows:

> *"The terms "royalties" as used in this Article means payments of any kind received as a consideration for the use of or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*

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[7] Supra note 1

[8] supra note 1

Compared to the definition in Explanation 2(iii) of 9(1)(vi) the only distinction between the two was one of punctuation, specifically, the existence of a single "comma" following the word "*process*" in Article 12(4), a comma which is absent from the definition under domestic law. The only question was whether this comma dictated a particular consequence, namely whether its presence would mean that the word secret did qualify the word process in Article 12(4), and that its absence under domestic law would mean that it did not. In other words, if the comma was allowed to influence the interpretation of Article 12(4), it would mean that for the purposes of consideration to be termed as royalty under the DTAA, the process utilized would necessarily have to be a "secret process", whereas the position under domestic law is that the secrecy or not of the process utilized is irrelevant. After delving into a list of case law which lay down the rules for when punctuation is *not* to be taken seriously while interpreting an act or treaty, the AO decided that the presence of the comma was inconsequential. Here too, without prejudice to its above finding, the AO held that the process of providing the transponder would still qualify as a secret process. Quoting the Oxford Dictionary, the AO held that secret means kept or meant to be kept private, unknown or hidden from all but a few. It was held that the process was within the exclusive knowledge of the assessee. *The customer is neither in the know nor is it empowered to use the process in its own way.*

Post Finance Act 2012

18. It can be seen, therefore, that while the assessment orders consistently held that the income from data transmission services shall be taxable under Section 9(1)(vi) as royalty, the Tribunal equally consistently, set aside these

orders applying, as it is bound to do so, on the basis of *Asia Satellite*[9].However, as it has been noted, the Finance Act of 2012 amended Section 9(1)(vi) inserted Explanation 4, 5, and 6. The inclusion of these Explanations, clarificatory as they claim they are, have attempted to undo the implications of *Asia Satellite.*[10]Explanations 4, 5, and 6 are reproduced below:

> *"Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.*
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> *Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—*
>
> *(a) the possession or control of such right, property or information is with the payer;*
> *(b) such right, property or information is used directly by the payer;*
> *(c) the location of such right, property or information is in India.*
>
> *Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;"*

Contentions of parties

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[9] supra note 1

[10] supra note 1

19. The Revenue argues in their appeals that with the insertion of the three explanations to Section 9 (1)(vi) of the Act, the matter has been settled beyond controversy. Consequently, the impugned orders, based as they are, on the reasoning in *Asia Satellite*[11]., cannot stand, because the basis of that ruling has been undone. It was argued that it matters little as to whether the amendment is held to be declaratory or clarificatory, because it imperatively suggests that if there were any doubts as to whether the activity was taxable, those stood removed. Necessarily, the amendment therefore, applied to all transactions- past and present. *Asia Satellite*[12], therefore, was statutorily overborne. For this simple reason alone, argued counsel, the impugned orders are to be set aside and the matters remitted to the AO to give tax effect and work out the assessee's liabilities.

20. It was submitted that as far as the second question, i.e. whether the DTAA applied and resulted rendering the activity non-taxable was concerned, the question should not arise. Here, learned counsel stated that the DTAA predated the amendment. Consequently, the interpretation placed in *Asia Satellite*[13], which was in relation to Section 9, could not be said to be an authority on treaty interpretation. Furthermore, argued counsel for the Revenue, the terms of the treaty and the terms of the pre-amended Act being similar, the subsequent amendment rendered the reasoning in *Asia Satellite* academic. Therefore, the assessees could not take shelter under the DTAA, which was cast in identical terms with the pre-amended statute. Since the

[11] supra note 1
[12] supra note 1
[13] supra note 1

same has subsequently been amended, the Courts are bound to give effect to it.

21. Learned counsel for the assessees contended that the matter is no longer *res integra*. It was submitted that having regard to the structure of Section 92 of the Act, there is little elbow room for the Revenue; it cannot be contended that any change in the substantive law would automatically result in a like change in respect of taxability of a transaction or service, which is otherwise tax exempt in terms of a DTAA or which is subject to a lower rate of taxation mandated by a treaty. Counsel relied on the judgment of the Bombay High Court in *Commissioner of Income Tax v. Seimens Aktiongesellschaft*[14]and the Andhra Pradesh High Court in *M/s Sanofi Pasteur Holding SA v. Department of Revenue.*[15].

22. Learned counsel, most importantly stressed upon the decision of this Court, in *Director of Income Tax v Nokia Networks*[16]which had dealt with a similar issue, with respect to applicability of the amended Section 9 (1) (vi) in the light of insertion of the Explanations, the context being the efficacy of the interpretation given to the statute vis-à-vis a double taxation avoidance treaty. In that case, this Court had rejected that any amendment could change the situation and render the service or activity taxable.

23. Taking the argument to its logical end, counsel further argued that it is not possible for one nation to, by way of a unilateral amendment to tax income which otherwise was not subject to tax under the treaty. In other words, argued counsel, the rule of referential incorporation cannot be

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[14] [2009] 310 ITR 320

[15] (2013) 354 ITR 316 (AP)

[16] 2013 (358) ITR 259

applied in dealing with a DTAA between two Sovereign Nations. Though it is open to a Sovereign Legislature to amend its Laws, a DTAA entered into by the Government has to be reasonably construed.

Analysis and Conclusions:

24. International double taxation typically occurs when two jurisdictions claim the right to tax the same tax entity or subject with respect to the same income for the same period. Indisputably, taxation of income twice over by two different jurisdictions has an adverse impact on the movement of goods and services across international borders. For this purpose, jurisdictions with concurrent taxing rights enter into Double Tax Avoidance Agreements, which set rules that attempt, at the very least, theoretically, to eliminate a double incidence of tax. The States therefore limit their legitimate taxing powers in favour of the other State, by either agreeing not to tax a certain income, which has been reserved for the other Contracting State, or taxing that income to a limited extent. These treaties therefore have the effect of restraining the operation of the domestic taxing laws of a Contracting State. Justifiably, the balance between the domestic law of the Contracting State and its obligations under the treaty is a delicate matter worthy of critical consideration and is often the subject of Parliamentary legislation. In this context, Section 90 of the Act of 1961, which is law relatable to Article 253 of the Constitution, read with Entries 13, 14 and 82 of List 1 of the Seventh Schedule holds the field. It states that where the Central Government has entered into a Double Tax Avoidance Agreement, then in relation to the taxpayer who is contemplated by such agreement, the provisions of the Act shall apply to the extent that they are more beneficial to the assessee.

25. The underlying presumption of a DTAA being that in the absence of such agreement, the income in question is taxable in both jurisdictions as under their domestic laws, whenever Courts are confronted with taxability of an income in the context of such an agreement, they must as a matter of course, first decide whether the income in issue is taxable under domestic legislation, specifically the Act. It is only when that issue is answered in the affirmative that the Court turns its attention to the tax convention in issue, to ascertain primarily whether the terms of the convention exempt that particular income from being taxed under the Act.

26. Section 9(1)(vi) is, aside from changes made by the Finance Act, 2012, a long and winding provision, subject to several explanations and provisos. It will therefore be prudent to undertake a systematic approach to it, whereby each stage of the section is examined. The opening words of Section 9; *"the following incomes shall be deemed to accrue or arise in India"* indicate at the outset that the provision is a deeming one whereby, income otherwise not accruing in India, *will be deemed to* have accrued in certain cases. Until 1922, various provisions enumerated cases under which income accruing to an assessee abroad was deemed to accrue in India. The 1961 Act collects these provisions and covers them under the ambit of Section 9. One of such deeming provisions is Section 9(1)(vi), which states that income by way of royalty, shall be deemed to have accrued in India. For income of such nature to be taxable under the Act, two aspects must be examined, first, whether the income partakes the character of royalty as defined in Explanation 2, and second, depending on who it is payable by, whether the conditions governing payment by such person have been met. As to the second aspect, Section 9(1)(vi) begins with the following words:

> *"(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"*

Three categories are intended here, namely, (i) the Government, (ii) residents of India and (iii) non-residents. Once it is established that the income accruing to the assessee is in fact, royalty under the second Explanation, the individual conditions annexed to each of the three above must be met. In the present case, both residents as well as non-residents have paid the income purported to be taxed by the Revenue, which argues that the conditions for both have been satisfied. Briefly, royalty paid by a resident is taxable as long as it is not paid for the purpose of a business or profession carried on outside India or for the purposes of making or earning income from any source outside India. In the case of a non-resident, royalty paid shall be taxable when it is paid for the purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India. In other words, for both residents as well as non-residents, either of two situations must occur; (i) the business or profession for the purpose of which the royalty is paid must be carried on by such person in India or (ii) the royalty must be paid for the purposes of making or earning any income from any source situated in India.

27. Since the underlying premise is that the payment is "royalty", the Court must first deal with Explanation 2, most pertinently to sub-clause (iii) and (iva) under which the income in the present case is sought to be taxed.

> *"(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;*
>
> *(…)*
>
> *(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB"*

28. The two clauses as applicable to data transmission services have been the subject of debate in courts as well as business circles. The debate was finally settled by the judgment delivered in *Asia Satellite*[17]. In *Asia Satellite*[18]this Court held that income from data transmission services would not qualify as royalty in order for it to be taxable under the Act. The Court first recognized that the definition of royalty in the section is with respect to permission granted to use the right in respect of the patent, invention, process, etc., all essentially forms of intellectual property. This permission restricts itself merely to the letting of the licensed asset. The permission does not go so far as to allow alienation of the asset itself. That being said, it is not so restricted as to qualify as a case where the licensor uses the asset himself, albeit for the purposes of his customers. The Court took note of the features of the agreements between the assessee in that case, which was a

[17] supra note 1

[18] supra note 1

foreign company, incorporated in Hong Kong, and its customers, which were TV channels. The agreement was essentially one of allocation of the transponder capacity available on the satellite to enable the channels to relay their signals. The customers had their own relaying facilities. No different from the case at hand, the transponder receives the signal, amplifies it, and downlinks it to facilitate transmission of the signals. Quoting the judgment of the AAR in *ISRO*[19], the Court held that it becomes clear that all the customer gets through the agreement with the assessee is *mere access* to a broadband width available in the transponder. The control over the parts of the satellite and naturally the transponder remains with the assessee. At no point does the assessee cede control over the satellite to the customers. Logically therefore, since the transponder is a part of the satellite that cannot be severed from it, there can be no independent control of the transponder without control of the satellite itself. The AAR had specifically rejected the revenue's contention that in substance there is use of equipment; that being the transponder. 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 does not mean that control and operation of the transponder is with the customer. Interestingly, this has not escaped the notice of the AO, except that the Assessment Order conveniently employs the in-severability of the transponder from the satellite to assert that that the technology of the satellite would qualify as the "secret process" but conveniently divorces the transponder from the satellite while trying to prove that there is use of the transponder as an equipment. However, equipment as envisaged in the section must be capable of

[19] supra note 3

functioning independently, or in other words, must be able to perform an activity by itself without material reliance on another. Essentially therefore, *Asia Satellite*[20], held that the presence of control was a critical factor in adjudging whether there was "use" of a particular process. On the question of whether the "process" so used must be a secret process or not, the judgment did not return any finding specifically, other than quoting with approval the OECD Commentary which alludes to the indispensability of the secrecy of the process.

29. The Revenue argues that critical aspects of this judgment, primarily that the function performed by the transponder could not be categorized as a *"process"* and that even in the event it could be, there was no *"use"* of this process since there was no control exercised by the customers, is no longer good law in light of the inclusion of Explanations 4-6 by the Finance Act, 2012. In other words the Revenue contends that a mere reading of Explanation 4-6 will go to show that they are clarificatory and are therefore automatically retrospective. By this reason, as clarificatory amendments do, these explanations relate back to the time when the main provision of Section 9(1)(vi) first came into force. By logical extension, the judgment in *Asia Satellite*[21]was based on a misinterpretation of the section and thus no longer holds the field or corresponds to the correct interpretation of the definition of royalty.

30. Undoubtedly, the legislature is competent to amend a provision that operates retrospectively or prospectively. Nonetheless, when disputes as to their applicability arise in court, it is the actual substance of the amendment

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[20] supra note 1

[21] supra note 1

that determines its ultimate operation and not the bare language in which such amendment is couched. Two judgments of note have succeeded the Finance Act, 2012 in this context. In *Director of Income Tax v. TV Today Network Limited*[22] , a Division Bench of this Court was confronted with the question of taxability of income from data transmission services. Answering the question in favour of the Revenue, the Court held that as far as the domestic taxability of the said income is concerned, the Finance Act 2012 mandates it to be as such. Interestingly however, the Court did not rule out any relief that the assessees may be entitled to by virtue of the DTAA between India and the United States for the simple reason that the ITAT had not rendered any finding in that regard. Resultantly, the Court remitted the matter to the ITAT to decide that question.

> *"In an appeal under Section 260A of the Act, we are not required to consider the constitutional validity and vires of the said amendments but have to apply the amended provision. In view of the said statutory amendments, the reasoning given by the Tribunal cannot be sustained is has to be reversed.*
>
> *Learned counsel for the respondent assessee has however rightly drawn our attention to the assessment order in which the assessee had also pleaded and submitted that the payments made cannot be considered as royalty or fee for included services as defined in the Double Taxation Avoidance Agreement (DTAA) between India and United states of America. It is submitted that the payments were business profit and accordingly not taxable or chargeable to tax under the Act. The tribunal has not referred to and examined the effect of the DTAA between India and the USA and whether the assessee is entitled to benefit or advantage under the said agreement and therefore, payments made were not taxable in India in the hands of the recipient. Accordingly while answering the question of law in favour of the Revenue we pass*

[22] ITA 600/2012 decided on 12.11.2013

> *an order of remit and ask the tribunal to decide the other contention raised by the respondent assessee; whether the payments made nevertheless remain untaxable in view of the provisions of the DTAA."*

31. In a judgment by the Madras High Court in *Verizon Communications Singapore Pte Ltd. V. The Income Tax Officer, International Taxation I*[23], the Court held the Explanations to be applicable to not only the domestic definition but also carried them to influence the meaning of royalty under Article 12. Notably, in both cases, the clarificatory nature of the amendment was not questioned, but was instead applied squarely to assessment years predating the amendment. The crucial difference between the judgments however lies in the application of the amendments to the DTAA. While *TV Today*[24]recognizes that the question will have to be decided and the submission argued, *Verizon*[25]cites no reason for the extension of the amendments to the DTAA.

32. Explanations 4-6 are designed as clarificatory amendments. Unarguably they have all the apparent characteristics of one. The words "*for the removal of doubts, it is hereby clarified…includes and has always included*" qualify the interpretation in Explanation 5. In Explanation 6, the same words have been modified and they state "*includes and has always deemed to have always included*". This is the standard language used to communicate an intended retrospective effect.

33. There is a general presumption against retrospectivity of an

[23] [2014] 361 ITR 575 (Mad)
[24] supra note 22
[25] supra note 23

amendment. This is the principle of *lex prospicit non respicit* which implies that unless explicitly stated, a piece of legislation is presumed not be intended to have retrospective operation.

34. Most recently in *Commissioner of Income tax (Central)-1, New Delhi v. Vatika Township Private Limited*[26], the Constitution Bench, while quoting *Govind Das v. Income Tax Officer*[27]and CIT Bombay Scindia Steam Navigation Company Ltd. [28]held as follows:

> *"31. Of the various rules guiding how a legislation has to be interpreted, one established rule is that unless a contrary intention appears, a legislation is presumed not to be intended to have a retrospective operation. The idea behind the rule is that a current law should govern current activities. Law passed today cannot apply to the events of the past. If we do something today, we do it keeping in view the law of today and in force and not tomorrow's backward adjustment of it. Our belief in the nature of the law is founded on the bed rock that every human being is entitled to arrange his affairs by relying on the existing law and should not find that his plans have been retrospectively upset. This principle of law is known as lex prospicit non respicit : law looks forward not backward. As was observed in Phillips vs. Eyre (1870) LR 6 QB 1, a retrospective legislation is contrary to the general principle that legislation by which the conduct of mankind is to be regulated when introduced for the first time to deal with future acts ought not to change the character of past transactions carried on upon the faith of the then existing law."*

35. This presumption against retrospectivity stems from an indispensible need for each rule of law to answer to the principle of fairness. *L'Office Cherifien des Phosphates v. Yamashita-Shinnihon Steamship Company*

[26] (2015) 1 SCC 1
[27] [1976] 1 SCC 906
[28] [1962] 1 SCR

Ltd.[29]. This presumption can be displaced in either of two situations, (i) where the words of the amendment specifically indicate the retroactivity of the law or (ii) in the case of declaratory or clarificatory amendments. Clarificatory amendments are a special class of amendments the object of which is self-evident, that is to say, it purports to "clarify" law that has already been legislated, essentially an Act to remove doubts existing as to the meaning or effect of a statute. Naturally therefore, they must be read as intrinsic and implicit, but overlooked elements of the original section itself. They thus dictate the interpretation of law *since the time it was first drafted or brought into force*. However, in order for such clarificatory amendments to be sustained as retrospective, they must answer to this description.

36. A clarificatory amendment presumes the existence of a provision the language of which is obscure, ambiguous, may have made an obvious omission, or is capable of more than one meaning. In such case, a subsequent provision dealing with the same subject may throw light upon it. Yet, it is not every time that the legislature characterizes an amendment as retrospective that the Court will give such effect to it. This is not in derogation of the express words of the law in question, (which as a matter of course must be the first to be given effect to), but because the law which was intended to be given retrospective effect to as a clarificatory amendment, is in its true nature one that expands the scope of the section it seeks to clarify, and resultantly introduces new principles, upon which liabilities might arise. Such amendments though framed as clarificatory, are in fact transformative substantive amendments, and incapable of being given retrospective effect.

[29] [1994] 1 AC 486

In *R. Rajagopal Reddy and Ors. v. Padmini Chandrasekharan*[30], it was held that the use of the words *"it is declared"* is not conclusive that the Act is declaratory because it may be used to introduce new rules of law. If the amendment changes the law it is not presumed to be retrospective irrespective of the fact that the phrase used is "it is declared" or for the removal of doubts". In determining, therefore, the nature of the Act, regard must be had to the substance rather than to form. While adjudging whether an amendment was clarificatory or substantive in nature, and whether it will have retrospective effect or not, it was held in *CIT v. Gold Coin Health Food (P) Ltd.*[31] and *CIT v. Podar Cement (P) Ltd.*[32]that, (i) the circumstances under which the amendment was brought in existence, (ii) the consequences of the amendment, and (iii) the scheme of the statute prior and subsequent to the amendment will have to be taken note of.

37. An important question, which arises in this context, is whether a "clarificatory" amendment remains true to its nature when it purports to annul, or has the undeniable effect of annulling, an interpretation given by the courts to the term sought to be clarified. In other words, does the rule against clarificatory amendments laying down new principles of law extend to situations where law had been judicially interpreted and the legislature seeks to overcome it by declaring that the law in question was never meant to have the import given to it by the Court? The general position of the courts in this regard is where the purpose of a special interpretive statute is to correct a judicial interpretation of a prior law, which the legislature

[30] (1995) 2 SCC 630
[31] (2008) 9 SCC 662
[32] (1997) 5 SCC 482

considers inaccurate, the effect is prospective. Any other result would make the legislature a court of last resort. *United States v. Gilmore* 8 Wall[33], *Peony Park v. O'Malley*[34]. It does not mean that the legislature does not have the power to override judicial decisions which in its opinion it deems as incorrect, however to respect the seperation of legal powers and to avoid making a legislature a court of last resort, the amendments can be made prospective only (Ref. *County of Sacremento v. State*[35], *In re Marriage of Davies*[36]).

38. The circumstances in this case could very well go to show that the amendment was no more than an exercise in undoing an interpretation of the court which removed income from data transmission services from taxability under Section 9(1)(vi). It would also be difficult, if not impossible to argue, that inclusion of a certain specific category of services or payments within the ambit of a definition alludes not to an attempt to illuminate or clarify a perceived ambiguity or obscurity as to interpretation of the definition itself, but towards enlarging its scope. Predicated upon this, the retrospectivity of the amendment could well be a contentious issue. Be that as it may, this Court is disinclined to conclusively determine or record a finding as to whether the amendment to 9(1)(vi) is indeed merely clarificatory as the Revenue suggests it is, or prospective, given what its nature may truly be. The issue of taxability of the income of the assessees in this case may be resolved without redressal of the above question purely because the assessee has not pressed this line of arguments before the court and has instead stated

[33] (75 US) 330, 19 L Ed 396 (1869)

[34] 223 F2d 668 (8th Cir. 1955)

[35] 134 Cal App 3d 428

[36] 105 Ill App 3d 661

that even if it were to be assumed that the contention of the Revenue is correct, the ultimate taxability of this income shall rest on the interpretation of the terms of the DTAAs. Learned Counsel for the assessee has therefore contended that even if the first question is answered in favour of the Revenue, the income shall nevertheless escape the Act by reason of the DTAA. The court therefore proceeds with the assumption that the amendment is retrospective and the income is taxable under the Act.

39. It is now essential to decide the second question i.e. whether the assessees in the present case will obtain any relief from the provisions of the DTAAs. Under Article 12 of the Double Tax Avoidance Agreements, the general rule states that whereas the State of Residence shall have the primary right to tax royalties, the Source State shall concurrently have the right to tax the income, to the extent of 15% of the total income. Before the amendment brought about by the Finance Act of 2012, the definition of royalty under the Act and the DTAAs were treated as *pari materia*. The definitions are reproduced below:

Article 12(3), Indo Thai Double Tax Avoidance Agreement:

> *"3. The term "royalties" as used in this article means payments of any kind received as a consideration for the alienation or the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, phonographic records and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."*

Article 12(4), Indo Netherlands Double Tax Avoidance Agreement

> *"4. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary**,** artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*

> Section 9(1)(vi), Explanation 2, Income Tax Act, 1961
>
> *"(iii) the use of any patent, invention, model, design**,** secret formula or process or trade mark or similar property"*

40. In *Asia Satellite*[37] the Court, while interpreting the definition of royalty under the Act, placed reliance on the definition in the OECD Model Convention. Similar cases, before the Tax Tribunals through the nation, even while disagreeing on the ultimate import of the definition of the word royalty in the context of data transmission services, systematically and without exception, have treated the two definitions as *pari materia*. This Court cannot take a different view, nor is inclined to disagree with this approach for it is imperative that definitions that are similarly worded be interpreted similarly in order to avoid incongruity between the two. This is, of course, unless law mandates that they be treated differently. The Finance Act of 2012 has now, as observed earlier, introduced Explanations 4, 5, and 6 to the Section 9(1)(vi). The question is therefore, whether in an attempt to interpret the two definitions uniformly, i.e. the domestic definition and the treaty definition, the amendments will have to be read into the treaty as well. In essence, will the interpretation given to the DTAAs fluctuate with successive Finance Act amendments, whether retrospective or prospective?

[37] supra note 1

The Revenue argues that it must, while the Assessees argue to the contrary. This Court is inclined to uphold the contention of the latter.

41. This Court is of the view that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend in operation to the terms of an international treaty. In other words, a clarificatory or declaratory amendment, much less one which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment. In the context of international law, while not every attempt to subvert the obligations under the treaty is a breach, it is nevertheless a failure to give effect to the intended trajectory of the treaty. Employing interpretive amendments in domestic law as a means to imply contoured effects in the enforcement of treaties is one such attempt, which falls just short of a breach, but is nevertheless, in the opinion of this Court, indefensible.

42. It takes little imagination to comprehend the extent and length of negotiations that take place when two nations decide to regulate the reach and application of their legitimate taxing powers. In *Union of India v. Azadi Bachao Andolan*,[38]where the Indo Mauritius Double Tax Avoidance Convention was before the Supreme Court, the Court said the following of the essential nature of these treaties,

> *"132. An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including one for double taxation relief is that treaties are negotiated and entered into at a political level go ahead and have several considerations as their bases. Commenting on this*

[38] (2003) 263 ITR 706 (SC)

aspect of the matter, David R. Davis in Principles of International Double Taxation Relief , David R. Davis, Principles of International Double Taxation Relief , Pg.4 (London Sweet & Maxwell, 1985)points out that the main function of a Double Taxation Avoidance Treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. It is observed (vide para 1.06):

"The benefits and detriments of a double tax treaty will probably only be truly reciprocal where the flow of trade and investment between treaty partners is generally in balance. Where this is not the case, the benefits of the treaty may be weighted more in favour of one treaty partner than the other, even though the provisions of the treaty are expressed in reciprocal terms. This has been identified as occurring in relation to tax treaties between developed and developing countries, where the flow of trade and investment is largely one way.

Because treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient quid pro quo is obtained by both sides."

43. The Vienna Convention on the Law of Treaties, 1969 ("VCLT") is universally accepted as authoritatively laying down the principles governing the law of treaties. Article 39 therein states the general rule regarding the amendment of treaties and provides that a treaty may be amended by agreement between the parties. The rules laid down in Part II of the VCLT apply to such an agreement except insofar as the treaty may otherwise provide. This provision therefore clearly states that an amendment to a treaty must be brought about *by agreement* between the parties. Unilateral

amendments to treaties are therefore categorically prohibited.

44. We do not however rest our decision on the principles of the VCLT, but root it in the inability of the Parliament to effect amendments to international instruments and directly and logically, the illegality of any Executive action which seeks to apply domestic law amendments to the terms of the treaty, thereby indirectly, but effectively amending the treaty unilaterally. As held in *Azadi Bachao Andolan*[39]these treaties are creations of a different process subject to negotiations by sovereign nations. The Madras High Court, in *Commissioner of Income Tax v VR. S.RM. Firms Ors*[40] held that *"tax treaties are...... considered to be mini legislation containing in themselves all the relevant aspects or features which are at variance with the general taxation laws of the respective countries".*

45. At the very outset, it should be understood that it is not as if the DTAAs completely prohibit reliance on domestic law. Under these, a reference is made to the domestic law of the Contracting States. Article 3(2) of both DTAAs state that in the course of application of the treaty, any term *not defined* in the treaty, shall, have the meaning which is imputed to it in the laws in force in that State relating to the taxes which are the subject of the Convention.

> *"Indo Thailand DTAA:*
>
> *"ARTICLE 3: GENERAL DEFINITIONS*
>
> *2. In the application on the provisions of this Convention by one of the Contracting States, any term not defined herein shall, unless the context otherwise requires, have the meaning which it*

[39] supra note 36

[40] [1994] 208 ITR 400 (Mad)

has for the purposes of the laws in force in that State relating to the taxes which are the subject of this Convention.

Indo Netherlands DTAA:

ARTICLE 3: GENERAL DEFINITIONS

2. As regards the application of the Convention by one of the States any term not defined herein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies.

The treaties therefore, create a bifurcation between those terms, which have been defined by them (i.e the concerned treaty), and those, which remain undefined. It is in the latter instance that domestic law shall mandatorily supply the import to be given to the word in question. In the former case however, the words in the treaty will be controlled by the definitions of those words in the treaty if they are so provided.

46. Though this has been the general rule, much discussion has also taken place on whether an interpretation given to a treaty alters with a transformation in, or amendments in, domestic law of one of the State parties. At any given point, does a reference to the treaty point to the law of the Contracting States at the time the treaty was concluded, or relate to the law of the States as existing at the time of the reference to the treaty? The former is the 'static' approach while the latter is called the 'ambulatory' approach. One opportunity for a State to ease its obligations under a tax convention comes from the ambulatory reference to domestic law. States seeking to furtively dodge the limitations that such treaties impose,

sometimes, resort to amending their domestic laws, all the while under the protection of the theory of ambulatory reference. It thereby allows itself an adjustment to broaden the scope of circumstances under which it is allowed to tax under a treaty. A convenient opportunity sometimes presents itself in the form of ambiguous technical formulations in the concerned treaty. States attempting to clarify or concretize any one of these meanings, (unsurprisingly the one that benefits it) enact domestic legislation which subserves such purpose.

47. In this context, recently in *M/s Sanofi Pasteur Holding SA v. Department of Revenue*[41], the Andhra Pradesh High Court discussed and subscribed to the ratio of the Supreme Court of Canada in *R. v. Melford Developments Inc.*[42] with respect to the applicability of domestic amendments to international instruments. In *R v. Melford*[43], the Canadian Supreme Court in a first, held that the ambulatory approach is antithetical to treaty obligations:

> *"There are 26 concluded and 10 proposed tax conventions, treaties or agreements between Canada and other nations of the world. If the submission of the appellant is correct, these agreements are all put in peril by any legislative action taken by Parliament with reference to the revision of the Income Tax Act. For this practical reason one finds it difficult to conclude that Parliament has left its own handiwork of 1956 in such inadvertent jeopardy. That is not to say that before the 1956 Act can be amended in substance it must be done by Parliament in an Act entitled "An act to Amend the Act of 1956". But neither is the converse true, that is that every tax enactment adopted for whatever purpose, might have the effect of amending one or more*

[41] supra note 15

[42] 36 DTC 6281 (1982)

[43] supra note 40

bilateral or multilateral tax conventions without any avowed purpose or intention so to do."

48. In *Commissioner of Income Tax v. Seimens Aktiongessellschaft*[44], the Bombay High Court citing *R v. Melford Developments Inc*. held that

> *"The ratio of the judgment, in our opinion, would mean that by a unilateral amendment it is not possible for one nation which is party to an agreement to tax income which otherwise was not subject to tax. Such income would not be subject to tax under the expression "laws in force".*
>
> ********** ********* *********
>
> *While considering the Double Tax Avoidance Agreement the expression "laws in force" would not only include a tax already covered by the treaty but would also include any other tax as taxes of a substantially similar character subsequent to the date of the agreement as set out in article I(2). Considering the express language of article I(2) it is not possible to accept the broad proposition urged on behalf of the assessee that the law would be the law as applicable or as define when the Double Tax Avoidance Agreement was entered into."*

49. It is essential to note the context in which this judgment was delivered. There, the Court was confronted with a situation where the word royalty was *not defined* in the German DTAA. Following from our previous discussion on the bifurcation of terms within the treaty, in situations where words remain undefined, assistance is to be drawn from the definition and import of the words as they exist in the domestic "laws in force". It was in this context that the Bombay High Court held that they were unable to accept the assesse's contention that the law applicable would be the law as it existed at the time the Double Tax Avoidance Agreement was entered into.

[44] [2009] 310 ITR 320 (Bom)

This is the context in which the ambulatory approach to tax treaty interpretation was not rejected. The situation before this Court however is materially different as there is in fact a definition of the word royalty under Article 12 of both DTAA, thus dispensing with the need for recourse to Article 3.

50. There are therefore two sets of circumstances. First, where there exists no definition of a word in issue within the DTAA itself, regard is to be had to the laws in force in the jurisdiction of the State called upon to interpret the word. The Bombay High Court seems to accept the ambulatory approach in such a situation, thus allowing for successive amendments into the realm of "laws in force". We express no opinion in this regard since it is not in issue before this Court. This Court's finding is in the context of the second situation, <u>where there does exist a definition of a term within the DTAA</u>. When that is the case, there is no need to refer to the laws in force in the Contracting States, especially to deduce the meaning of the definition under the DTAA and the ultimate taxability of the income under the agreement. That is not to say that the Court may be inconsistent in its interpretation of similar definitions. What that does imply however, is that just because there is a domestic definition similar to the one under the DTAA, amendments to the domestic law, in an attempt to contour, restrict or expand the definition under its statute, cannot extend to the definition under the DTAA. In other words, the domestic law remains static for the purposes of the DTAA. The Court in *Sanofi* (supra)[45] had also held similarly:

> *"We are in agreement with the petitioners and in the light of our preceding analyses, discern no textual, grammatical or syntactic*

[45] supra note 43

ambiguity in Article 14(5), warranting an interpretive recourse. In the circumstances, invoking provisions of Article 3(2) by an artificial insemination of ambiguity (to accommodate an expanded meaning to the DTAA provision), would be contrary to good faith interpretation. A further problematic of contriving an ambiguity to unwarrantedly invite application of domestic law of a contracting State would be that while India would interpret an undefined DTAA provision according to the provisions of the Act, France could do so by reference to its tax code. As a consequence, the purpose of entering into a treaty with a view to avoiding double-taxation of cross-border transactions would be frustrated."

51. Pertinently, this Court in *Director of Income Tax v Nokia Networks*[46] specifically dealt with the question of the effect of amendments to domestic law and the manner of their operation on parallel treaties. The Court delivered its judgment in the context of the very amendments that are in question today; the Explanations to Section 9(1)(vi) vis a vis the interpretation of a Double Tax Avoidance Agreement. This Court rejected that any amendment could change the situation and render the service or activity taxable, in the following observations:

"He, thus submitted that the question of "copyrighted article" or actual copyright does not arise in the context of software both in the DTAA and in the Income Tax Act since the right to use simpliciter of a software program itself is a part of the copyright in the software irrespective of whether or not a further right to make copies is granted. The decision of the Delhi Bench of the ITAT has dealt with this aspect in its judgment in Gracemac Co. Vs. ADIT 134 TTJ (Delhi) 257 pointing out that even software bought off the shelf, does not constitute a "copyrighted article" as sought to be made out by the Special Bench of the ITAT in the present case. However, the above argument misses the vital point namely the assessee has opted to be governed by the treaty and

[46] 2013 (358) ITR 259

> *the language of the said treaty differs from the amended Section 9 of the Act. It is categorically held in CIT Vs. Siemens Aktiongesellschaft, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty. On the wording of the treaty, we have already held in Ericsson (supra) that a copyrighted article does not fall within the purview of Royalty. Therefore, we decide question of law no.1 & 2 in favour of the assessee and against the Revenue."*

52. Thus, an interpretive exercise by the Parliament cannot be taken so far as to control the meaning of a word expressly defined in a treaty. Parliament, supreme as it may be, is not equipped, with the power to amend a treaty. It is certainly true that law laid down by the Parliament in our domestic context, even if it were in violation of treaty principles, is to be given effect to; but where the State unilaterally seeks to amend a treaty through its legislature, the situation becomes one quite different from when it breaches the treaty. In the latter case, while internationally condemnable, the State's power to breach very much exists; Courts in India have no jurisdiction in the matter, because in the absence of *enactment through appropriate legislation in accordance with Article 253 of the Constitution, courts do not possess any power to pronounce on the power of the State to enact a law contrary to its treaty obligations*. The domestic courts, in other words, are not empowered to legally strike down such action, as they cannot dictate the executive action of the State in the context of an international treaty, unless of course, the Constitution enables them to. That being said, the amendment to a treaty is not on the same footing. The Parliament is simply not equipped with the power to, through domestic law, change the terms of a treaty. A treaty to begin with, is not drafted by the Parliament; it is an act of the Executive.

Logically therefore, the Executive cannot employ an amendment within the domestic laws of the State to imply an amendment within the treaty. Moreover, a treaty of this nature is a carefully negotiated economic bargain between two States. No one party to the treaty can ascribe to itself the power to unilaterally change the terms of the treaty and annul this economic bargain. It may decide to not follow the treaty, it may chose to renege from its obligations under it and exit it, but it cannot amend the treaty, especially by employing domestic law. The principle is reciprocal. Every treaty entered into be the Indian State, unless self-executory, becomes operative within the State once Parliament passes a law to such effect, which governs the relationship between the treaty terms and the other laws of the State. It then becomes part of the general conspectus of domestic law. Now, if an amendment were to be effected to the terms of such treaty, unless the existing operationalizing domestic law states that such amendments are to become automatically applicable, Parliament will have to by either a separate law, or through an amendment to the original law, make the amendment effective. Similarly, amendments to domestic law cannot be read into treaty provisions without amending the treaty itself.

53. Finally, States are expected to fulfill their obligations under a treaty in good faith. This includes the obligation to not defeat the purpose and object of the treaty. These obligations are rooted in customary international law, codified by the VCLT, especially Article 26 (binding nature of treaties and the obligation to perform them in good faith); Article 27 (Internal law and observance of treaties, i.e provisions of internal or municipal law of a nation cannot be used to justify omission to perform a treaty); General rule of interpretation under Article 31 (1) (i.e that it shall be interpreted in good

faith, in accordance with ordinary meaning to be given to the terms of a treaty) and Article 31 (4) (A special meaning shall be given to a term if it is established that the parties so intended).

The expression "process" and treaty interpretation in this case

54. Neither can an Act of Parliament supply or alter the boundaries of the definition under Article 12 of the DTAAs by supplying redundancy to any part of it. This becomes especially important in the context of Explanation 6, which states that whether the 'process' is secret or not is immaterial, the income from the use of such process is taxable, nonetheless. Explanation 6 precipitated from confusion on the question of whether it was vital that the "process" used must be secret or not. This confusion was brought about by a difference in the punctuation of the definitions in the DTAAs and the domestic definition. For greater clarity and to illustrate this difference, we reproduce the definitions of royalty across both DTAAs and sub clause (iii) to Explanation 2 to 9(1)(vi).

Article 12(3), Indo Thai Double Tax Avoidance Agreement:

> *3. The term "royalties" as used in this article means payments of any kind received as a consideration for the alienation or the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, phonographic records and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan,* ***secret formula or process,*** *or for the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."* (emphasis supplied)

Article 12(4), Indo Netherlands Double Tax Avoidance Agreement

> *"4. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary**,** artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan,* ***secret formula or process,*** *or for information concerning industrial, commercial or scientific experience."*
>
> (emphasis supplied)

Section 9(1)(vi), Explanation 2, Income Tax Act, 1961

> *(iii) the use of any patent, invention, model, design****, secret formula or process or trade mark or similar property;*** (emphasis supplied)

55. The slight but apparently vital difference between the definitions under the DTAA and the domestic definition is the presence of a comma following the word process in the former. In the initial determinations before various ITATs across the country, much discussion took place on the implications of the presence or absence of the "comma". A lot has been said about the relevance or otherwise of punctuation in the context of statutory construction. In spoken English, it would be unwise to argue against the importance of punctuation, where the placement of commas is notorious for diametrically opposite implications. However in the realm of statutory interpretation, courts are circumspect in allowing punctuation to dictate the meaning of provisions. Judge Caldwell once famously said *"The words control the punctuation marks, and not the punctuation marks the words."*

Holmes v. Pheonix Insurance Co.[47]. It has been held in *CGT v. Budur* [48]and *Hindustan Const v. CIT*[49] that while punctuation may assist in arriving at the correct construction, yet it cannot control the clear meaning of a statutory provision. It is but, a minor element in the construction of a statute, *Hindustan Const*[50].

56. The courts have however created an exception to the general rule that punctuation is not to be looked at to ascertain meaning. That exception operates wherever a statute is *carefully punctuated*. Only then should weight undoubtedly be given to punctuation; *CIT v. Loyal Textile*[51]; *Sama Alana Abdulla vs. State of Gujarat*[52]; *Mohd Shabbir vs. State of Maharashtra*[53]; *Lewis Pugh Evans Pugh vs. Ashutosh Sen*[54]; *Ashwini Kumar Ghose v. Arbinda Bose*[55]; *Pope Alliance Corporation v. Spanish River Pulp and Paper Mills Ltd.*[56]. An illustration of the aid derived from punctuation may be furnished from the case of *Mohd. Shabbir v. State of Maharashtra*[57] where Section 27 of the Drugs and Cosmetics Act, 1940 came up for construction. By this section whoever *"manufactures for sale, sells, stocks or exhibits for sale or distributes"* a drug without a license is liable for punishment. In holding that mere stocking shall not amount to an offence under the section, the Supreme Court pointed out the presence of comma

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[47] 98 F 240 (1899)
[48] 103 ITR 189
[49] 208 ITR 291
[50] supra note 46
[51] 231 ITR 573
[52] AIR 1996 SC 569
[53] AIR 1979 SC 564
[54] AIR 1929 Privy Council 69
[55] AIR 1952 SC 369
[56] AIR 1929 PC 38
[57] AIR 1979 SC 564

after *"manufactures for sale"* and *"sells"* and the absence of any comma after "stocks" was indicative of the fact "stocks" was to be read along with "for sale" and not in a manner so as to be divorced from it, an interpretation which would have been sound had there been a comma after the word "stocks". It was therefore held that only stocking for the purpose of sale would amount to an offence but not mere stocking.

57. However, the question, which then arises, is as follows. How is the court to decide whether a provision is carefully punctuated or not? The test-to decide whether a statute is carefully (read consciously) punctuated or not-would be to see what the consequence would be had the section been punctuated otherwise. Would there be any substantial difference in the import of the section if it were not punctuated the way it actually is? While this may not be conclusive evidence of a carefully punctuated provision, the repercussions go a long way to signify intent. If the inclusion or lack of a comma or a period gives rise to diametrically opposite consequences or large variations in taxing powers, as is in the present case, then the assumption must be that it was punctuated with a particular end in mind. The test therefore is not to see if it makes "grammatical sense" but to see if it takes on any "legal consequences".

58. Nevertheless, whether or not punctuation plays an important part in statute interpretation, the construction Parliament gives to such punctuation, or in this case, the irrelevancy that it imputes to it, cannot be carried over to an international instrument where such comma may or may not have been evidence of a deliberate inclusion to influence the reading of the section. There is sufficient evidence for us to conclude that the process referred to in Article 12 must in fact be a secret process and was always meant to be such.

In any event, the precincts of Indian law may not dictate such conclusion. That conclusion must be the result of an interpretation of the words employed in the law and the treatises, and discussions that are applicable and specially formulated for the purpose of that definition. The following extract from *Asia Satellite*[58] takes note of the OECD Commentary and *Klaus Vogel* on Double Tax Conventions, to show that the process must in fact be secret and that specifically, income from data transmission services do not partake of the nature of royalty.

> *"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*

[58] supra note 1

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 as 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….

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78. There are judgments of other High Courts also to the same effect.

(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."*

59. On a final note, India's change in position to the OECD Commentary cannot be a fact that influences the interpretation of the words defining royalty as they stand today. The only manner in which such change in position can be relevant is if such change is incorporated into the agreement itself and not otherwise. A change in executive position cannot bring about a unilateral legislative amendment into a treaty concluded between two sovereign states. It is fallacious to assume that any change made to domestic law to rectify a situation of mistaken interpretation can spontaneously further their case in an international treaty. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change. *It is imperative that such amendment is brought about in the agreement as well.* Any attempt short of this, even if it is evidence of the State's discomfort at letting data broadcast revenues slip by, will be insufficient to persuade this Court to hold that such amendments are applicable to the DTAAs.

60. Consequently, since we have held that the Finance Act, 2012 will not affect Article 12 of the DTAAs, it would follow that the first determinative interpretation given to the word "royalty" in *Asia Satellite*[59], when the definitions were in fact *pari materia* (in the absence of any contouring explanations), will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a Double Tax Avoidance Agreement, unless the said DTAAs are amended jointly by both parties to incorporate income from data transmission services as partaking of the nature of royalty, or amend the definition in a manner so

[59] supra note 1

that such income automatically becomes royalty. It is reiterated that the Court has not returned a finding on whether the amendment is in fact retrospective and applicable to cases preceding the Finance Act of 2012 where there exists no Double Tax Avoidance Agreement.

61. For the above reasons, it is held that the interpretation advanced by the Revenue cannot be accepted. The question of law framed is accordingly answered against the Revenue. The appeals fail and are dismissed, without any order as to costs.

**S. RAVINDRA BHAT
(JUDGE)**

**R.K. GAUBA
(JUDGE)**

FEBRUARY 08, 2016