



26 January 2010
India

Mr Jeffrey Owens
Director, CTPA
OECD
2, rue André Pascal
75775 Paris
France

Dear Mr Owens,

Re: Taxand comments on the OECD report on tax treaty issues related to common telecommunication transactions

Taxand welcomes the opportunity to submit comments on the discussion draft issued by the Organisation for Economic Co-operation and Development ('OECD') on tax treaty issues related to common telecommunication transactions. Our comments and recommendations on the Commentary on the OECD Model Tax Convention ('Commentary') are itemised with reference to the relevant sequential paragraphs.

1. Payments to satellite operators - comments on the draft Commentary

New paragraph 5.5 of the Commentary on Article 5

- 1.1. We agree that the location of a satellite in a geostationary orbit and the receipt of its signals in a particular area cannot determine the location of a Permanent Establishment ('PE') for



the satellite operator. Additionally, we recommend that the OECD clarify that even where satellite operator has an affiliate / enterprise in the source country to undertake some local activities and the satellite operator qualifies to have a PE in the source country due to such presence, the entire revenue of the satellite operator would not be chargeable to tax and only an appropriate amount attributable to the local activities per the principles of Article 7 would be taxed in the source country.

New paragraph 9.1 of the Commentary on Article 12

- 1.2. We agree that payments made for “transponder leasing” for the purpose of transmitting between satellite operators and their customers (including broadcasting and telecommunication enterprises) do not constitute royalties. We understand and agree that such payments do not constitute royalty since they do not refer to “use of, or right to use” property, or for information, referred to in the definition, i.e. they cannot be viewed, for instance, as payments for the **use of, or right to use, a secret process** since no secret technology is used or transferred to the operator.

We would like to highlight that tax authorities contend the provision of a transponder through which the telecasting / broadcasting companies are able to uplink and downlink in a desired area. This is considered a “process” and hence constitutes royalty under paragraph 2 of Article 12 of the OECD Model Tax Convention on Income and on Capital for the satellite operator. Additionally, tax authorities also contend that in order to constitute royalty the “process” need not be a “secret process”.

In our view, the use of a transponder does not involve any “process”. The word “process”, judged by the context and setting in which it is used in the Article, is seen to be surrounded by words denoting intellectual property rights (‘IPRs’). IPRs are either protected or capable



of being protected in law and therefore the word "process" should fit in with them, i.e. in order to constitute "royalty" the process must have the attributes of IPRs. Further, it should be appreciated that a "process" reflects the provision of services by the satellite operator but the "use of, or right to use of the process" is not granted to the broadcasting and telecommunication enterprises. The word "process" should not be interpreted literally, but according to the context and on the basis of the rule of *ejusdem generis* or *noscitur a sociis*¹. Additionally, as mentioned in the proposed paragraph 9.1 of the Commentary on Article 12, the "process" should be "secret" (i.e. one which remains "undivulged" and outside the public domain). In our view, such services solely use the transmission capacity of the transponder and payment is not made by the user for either a "process" or a "secret process".

Further, we agree with the OECD that a royalty payment for use of ICS equipment may well arise, where the owner of the satellite leases it to another party who operates it and may offer its data transmission capacity to third parties. However, we would like to emphasise the decisive criteria in such situations is that the owner of the satellite no longer has operational control of the satellite and has made available the satellite at the disposal of the other party which operates the satellite. A royalty payment, would however, not arise where the satellite owner continues to exercise operational control over the satellite and provides transmission services to another party which offers the same to third parties under a typical reseller model; the payments made by the third party to the satellite owner would qualify as payments of services even though the third party has further sold transmission capacity to other parties.

We recommend the OECD include the above position in its Commentary.

¹ When two or more words which are susceptible of analogous meaning are coupled together, they are understood to be used in their cognate sense.



New paragraph 9.1 of the Commentary on Article 12

- 1.3. We refer to the following extract in paragraph 9.1 of the Commentary on Article 12 and are largely in agreement with the position.

“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.”

We would like to mention that tax authorities are not accepting the above position and are contending that, to constitute “royalty”, it is not necessary for the instruments through which the “process” is carried out to be in the control or possession of the payer. Tax authorities contend that in the case of satellites, the physical control and possession of the “process” can neither be with the satellite companies nor with the telecasting companies. However the fact that telecasting companies are able to telecast their programmes by both uplinking and downlinking this “process” shows that they have “use” of the same equipment. We request the OECD to incorporate additional text to suitably clarify the arguments / doubts of the tax authorities and thereby mitigate litigation faced by satellite operators.



2. Roaming payments - comments on the draft Commentary

New paragraph 9.1 of the Commentary on Article 5

- 2.1. We agree with the discussion in the context of non-constitution of a PE for a foreign telecom operator on account of a “roaming” agreement with a telecom operator in the source country (‘domestic telecom operator’), since the latter’s telecom network is not operated or physically accessed by such foreign telecom operator. We also wish to emphasise that where the payments by foreign telecom operators to domestic telecom operators (which are typically between unrelated parties) adequately compensate for the use of the local network of the domestic telecom operators in the source state, all activities in the source state should be adequately compensated and no part of the income earned by the foreign operator is further attributable to the source state, per the principles enshrined in Article 7.

We recommend that the OECD consider including the above to strengthen the proposed position in the Commentary as this may also be helpful to alleviate litigation on such aspects.

New paragraph 9.2 of the Commentary on Article 12

- 2.2. We agree with the discussion that payments made by foreign telecom operators under “roaming agreements” do not constitute royalty since these are not made in consideration for the “use of, or right to use” property, or for information, referred to in the definition. We also agree that this position is appropriate for tax treaties that include leasing of industrial, commercial or scientific equipment since these payments are not for physical access provided to networks by the domestic telecom operator.



We believe that services provided by telecom operators under the “roaming” agreement are standard services / facilities and do not constitute royalty. Any equipment used for rendering service and payments only is not considered to be usage of equipment and does not constitute royalty. We recommend that the OECD add this clarification to further strengthen the position.

3. Payments under spectrum license - comments on the draft Commentary

New paragraph 9.3 of the Commentary on Article 12

3.1. Spectrum licenses are required by the telecom operator to provide a service and such licenses are often granted as part of individual licensing process. We understand that the radio spectrum is universally acknowledged to be a valuable limited public resource and thus subject to government regulations. These licenses are granted by the government authorities through lotteries, comparative evaluation approaches and auctions. These licenses are also fully tradable in the open market and can be amalgamated, divided, or re-assigned, in part or in whole, to third parties, based in a particular geographic area, bandwidth or both. A licensee can extend the geographic coverage or bandwidth of their license by acquiring an adjacent spectrum license from another licensee.

It is not entirely clear for which “spectrum license” transaction the OECD is seeking to clarify the position in the draft Commentary. Do payments made to Government bodies / telecom regulators for use or right to use the “spectrum license” preclude royalty or do payments for sub-licensing of “spectrum license” (obtained from Government bodies / telecom regulators)? We recommend that the OECD clarifies this in its Commentary.



4. Additions to the draft Commentary

In addition to the inclusions proposed in the draft Commentary, we recommend that the OECD also clarifies / incorporates a paragraph relating to the following transactions..

Payments to foreign / overseas telecom equipment supplier

- 4.1. In a typical transaction model, the foreign telecom equipment supplier undertakes supply of equipment to its customers in source country and the commissioning and installation of such equipments are separately undertaken by an affiliate / enterprise in the source country. Under some of these arrangements, the foreign equipment supplier also executes an umbrella agreement providing an overall guarantee for successful completion of supply, installation and commissioning of equipments in source country. The taxation of income accrued / arisen on supply of equipment by foreign enterprise has been a matter of concern in many jurisdictions. We wish to highlight that the tax authorities typically attempt to establish that the foreign supplier has a PE in the source country and hold that the supply of equipment is taxable in the source country.

In our view, the foreign equipment suppliers do not generally have a place of business in the source country in the form of either an office or branch or any other fixed place of business in relation to the offshore supply of equipment since the related activities are entirely conducted from outside the source country. Further, we believe that foreign suppliers would not satisfy the conditions / criteria as discussed in the Commentary to paragraph 1 of Article 5 of the OECD Model Tax Convention.

Further, tax authorities contend that the affiliate / enterprise in the source country constitute a dependent agent PE of the foreign equipment supplier in the source country. In this



context, we believe that under a typical transaction model, the affiliate / enterprise in the source country does not constitute a dependent agent PE in relation to the offshore equipment supply since it does not satisfy the conditions set out in the Commentary to paragraph 5 of Article 5 of the OECD Model Tax Convention.

Even if it is assumed that the affiliate / enterprise in the source country constitutes a dependent agent PE in the source country, no income related to the equipment supply could be attributed to the affiliate / enterprise in the source country.

We recommend the OECD (if in agreement with above position) includes such a clarification in its Commentary.

- 4.2. In some cases, the foreign telecom equipment supplier also supplies software along with equipment. Such software is typically embedded in the equipment itself. We wish to highlight that the tax authorities tend to separately tax the amount paid for software as a royalty income of the foreign telecom equipment supplier.

In our view, payments for software cannot be segregated and even if the amounts are separately agreed. Further, we believe that such payments would not constitute royalty under Article 12 of the OECD Model Tax Convention, i.e. it does not constitute “use of or right to use any copyright of literary, artistic or scientific work”. The above position is highlighted in the Commentary to Article 12 of the OECD Model Tax Convention and the Tax Advisory Group Report of the OECD.

In view of the above, we recommend the OECD (if in agreement with above position) includes such a clarification in its Commentary.



Payments to foreign technology service provider for mobile money transfer services

- 4.3. In a mobile money transfer, the key participants include bank, telecom operator, business correspondents, retailer, customers etc. Payments are made by participants in the source country (i.e. a bank, telecom operator or a business correspondent, etc.) for services provided by the foreign technology service provider in the source country. These services typically include selling of rights of using the technology in perpetuity to the participant in source country or licensing the rights for a specified period.

In our view, the taxability of the foreign technology service provider depends on the precise customised arrangement it has with the participants in the source country and its presence in the source country (if any). However, where the technology is provided on a perpetuity basis by the foreign technology service provider, it could be argued that such a transaction is tantamount to a sale and hence should not be taxable in the source country but where the technology is provided for a specified period. Tax treaty benefits could be availed in cases where there is the restrictive definition of royalty incorporating a 'make available' clause.

It would be helpful if the OECD incorporates guidance preferably with examples in its Commentary.



We appreciate this opportunity to provide comments and would be pleased to discuss this further and / or to participate in any further discussion on these matters. More information on how to contact us and about Taxand is provided as Appendix I. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

Kind regards,

Amod Khare & Darpan Mehta
Taxand India



APPENDIX I

CONTACT DETAILS

Amod Khare

Taxand India

T. +91 22 3021 7150

M. +91 98 2000 8594

E. amod.khare@bmr advisors.com

Darpan Mehta

Taxand India

T. +91 22 3021 7135

M. +91 97 6924 9148

E. darpan.mehta@bmr advisors.com

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