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TAX FLASH NEWS

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Payments received for the content delivery solutions for accelerating content and business processes online are not in the nature of FTS/royalty

Background

Recently, the Authority for Advance Rulings (AAR) in the case of Akamai Technologies Inc.[1] (the applicant) held that the payments received by the applicant from the Indian company under the Services Reseller Agreement for the content delivery solutions for accelerating content and business processes online are not in the nature of Fees for Technical Services (FTS) or royalty under the Income-tax Act, 1961 (the Act) as well as under the India-U.S. tax treaty (the tax treaty). Further, such transaction does not create the applicant's Permanent Establishment (PE) in India.

Facts of the case

- The Applicant is a company incorporated under the laws of the USA and is controlled and managed from USA. It is a technology company and is the leading global service provider for accelerating content and business processes online (solutions). It caters to customers who have web based applications/websites, etc. on the internet, to help deliver the web content faster and more reliably, as also handling specific requirements of the customers.

- The applicant has built its Akamai EdgePlatform comprising of 73,000 secure servers equipped with proprietary software and deployed in 70 countries. The Akamai EdgePlatform pulls content from the customer's web server by replicating the data therefrom, and continually monitors the internet traffic, trouble spots and overall conditions. This information is used intelligently to optimise routes and replicate content for faster, more reliable delivery. The end-users access the customer's website through the Akamai EdgePlatform, thereby avoiding the (slower) web server maintained by the customer.

- In order to sell its solutions in India, the applicant has entered into an Akamai Services Reseller Agreement, dated 7 January 2010 with Akamai Technologies Solutions India Private Limited (Akamai India or Reseller), a company incorporated in India. Under this Reseller Agreement, the applicant has appointed Akamai India as a non-exclusive reseller who is authorised to resell the applicant's solutions directly to customers in India.

Issues before the AAR

- Whether the payments received by the applicant from Akamai India under the Akamai Services Reseller Agreement for the content delivery solutions would be in the nature of FTS under the Act and under the India-US Treaty?

- Whether the amounts received by the applicant would be in the nature of royalty within under the Act and the tax treaty?

- Whether the applicant had PE in India under the provisions of Article 5 of the tax treaty?

AAR's ruling

FTS under the Act

- As per Explanation 2 to Section 9(1)(vii) of the Act, FTS means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). It is nobody's case that the services rendered are

[1]Akamai Technologies Inc. (AAR No. 1107 of 2011) – Taxsutra.com

managerial or consultancy in nature. As far as whether the services are in the nature of 'technical services', the term is not defined under the Act; however, the same has been interpreted in various judicial precedents.

- The solutions provided by the applicant are neither specialised nor exclusive and do not cater to individual requirements of the customer. The solutions are offered by the applicant through its Akamai EdgePlatform and they remain the same for all customers who avail the applicant's facility, irrespective of the business/website content.

- Relying on the decision of the Supreme Court in the case of Kotak Securities Limited[2], the AAR observed that if the Applicant is providing a standard facility to all who are willing to pay for it, then such standard facility cannot be termed as 'technical services' for the purposes of Explanation 2 to Section 9(1)(vii) of the Act. The Madras High Court's observations in the case of Skycell Communications Ltd.[3] relied upon by the Applicant also supports this view where the question was whether the subscription fee charged for a communication service can be classified as FTS.

- The principle upheld in other cases relied upon by the applicant also lead us to conclude that since the applicant is providing its solutions through the Akamai EdgePlatform to all customers alike, for accelerating the delivery of their content, irrespective of the nature of business/website content, they cannot be termed as specialised, exclusive and individual requirement of the customer so as to qualify as 'technical services'.

- On the issue of human intervention in providing technical services, the AAR agreed with the principle held in Bharti Cellular Limited[4], as also upheld by the Supreme Court, that a human element is a pre-requisite for characterising a service as a technical service and consequently treating payments for the same as FTS.

- The human involvement in the applicant's case is only in relation to the development of the Akamai EdgePlatform and for marketing and after sale services. The tax department's contention that there is human intervention while providing customer support and training is irrelevant to the question under consideration in the application. What is important to consider is whether there is any human intervention while rendering of 'solutions' and not in providing customer support or training.

- The Solutions are independently provided by the use of technology and that too, sophisticated technology which operates on an automatic and continuous basis. That does not mean that the applicant, which operates on such facilities, is rendering any technical services as contemplated in the definition of the term FTS.

- In view of the above, the payments received by the applicant from Akamai India for content delivery solutions are held to be outside the scope of FTS under the provisions of the Act.

FTS under the tax treaty

- With respect to Article12(4)(b), the tax department has contended that services are 'made available' by the applicant to Indian customers through the Indian company or directly by the applicant without elaborating as to how the provision of solutions by the applicant falls under the meaning of 'make available'.

- The solutions provided by the applicant to the customers only enable faster content delivery of the customer's website, etc. to the end users. They do not provide the customers/end users with any technological knowledge, skill etc. which enable them to apply it on their own in future to enjoy faster content delivery without recourse to the applicant. Thus, it cannot be said that the provision of solutions by the applicant to its customers in any way satisfy the 'make available' condition under the tax treaty.

- Therefore, the consideration received by the applicant from Akamai India cannot be considered as FTS under the tax treaty.

Royalty

- On reading of the provisions under the Act and the tax treaty, for a payment to be construed as royalty, the same would need to be in relation to the use or right to use or transfer of all or any rights in relation to:

  - Copyright, patent, trademark, design or model, plan, etc; or

  - Any secret formula or process; or

  - Information concerning industrial, commercial or scientific experience; or

  - Industrial, commercial or scientific equipment.

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[2] CIT v. Kotak Securities Limited [2016] 383 ITR 1 (SC)
[3] Skycell Communications Ltd v. DCIT [2001] 251 ITR 53 (Mad)
[4] CIT v. Bharti Cellular Ltd [2009] 319 ITR 139 (Del)

- The tax department made out a case that the applicant's case is similar to that of a software distributor. A regular software distributor distributes software to end users who would use it in their internal business which is actively used by the customer. However, in the case of the applicant, the Reseller Agreement does not entail providing any software (either in original or a copy) for the customer to use. The applicant does not part with either any software or a copy of the software with the customer nor with the reseller. The customer or the reseller are not provided with any software either on a tangible medium like a CD nor any link through which the computer software is accessed/downloaded by the customer.

- The software of the applicant is always housed in its own network and the reseller/customers do not get either the software or a copy of the software or access to the software.

- Thus, the applicant does not appear to be a software product distribution company. The applicant is a technology company which addresses internet access issues by using its own network of hardware and proprietary software to provide facilities to its customers.

- Since the equipment is used by the applicant itself or to provide solutions to Akamai India which are re-sold to the India customers, and Akamai India/Indian customers are not granted any right to use any equipment, the transaction is not covered under the definition of royalty.

- Akamai India/ Indian customers are neither aware of the tangible property which is used for providing the service nor are they aware of the location of the tangible property. The arrangement merely enhances the performance of the customers' websites.

- Even though the solutions may be provided using tangible property such as servers, databases, etc., Akamai India/the Indian customers do not have possession and control over the Akamai EdgePlatform/ website/server/any tangible property used in the provision of the solutions.

- As regards tax department's contention that grant of distribution rights to Akamai India involves transfer of copyright, it is observed that the tax department has tried to bring the applicant within the ambit of Section 14(b) and specifically Section 14(b)(ii) of the Copyright Act.

- Section 14(b) of Copyright Act is only applicable to the 'doing any act' or the 'authorizing of the doing of any act' only in case of a computer programme or a copy of the computer programme.

- The entire provisions of the Copyright Act do not apply to the applicant's transaction since by the said transaction the applicant does not act or provide rights to act in any 'work' which involves any computer or any copy of the computer software.

- The AAR does not agree with the tax department's contention that grant of distribution rights by the applicant involves grant to use trademark, which appears based on the view that certain other IPR such as 'branding' are licensed to the reseller in India.

- The perusal of the entire tenor of the agreement, the conduct of the parties, the business model and the various agreements with end customers, the invoices etc., does not bear out any intention of use of trademark per se by Akamai India for which payment has been made to the applicant. Thus when payments under reseller agreement are not towards any IPR/Trademarks, it cannot be covered within the definition of royalty for the purpose of taxability.

- With respect to tax department's contention that grant of distribution rights by the applicant involves grant to use 'process' belonging to it, the AAR observed that the Reseller Agreement nowhere entails any grant nor a transfer of right in the 'process' nor is there any use of 'process' as is required under the tax treaty. If at all there is a process which is 'used', it is by the applicant itself to render the outsourced infrastructure services to the end user.

- The decisions relied by the taxpayer rendered in the context of software distribution transactions which are distinguished on the basis of facts of this case.

- The tax department's reliance on Vodafone South Ltd.[5] and Verizon Communications Singapore Pvt. Ltd.[6] is also misplaced, as these decisions have been rendered in the context of interconnectivity charges paid by a customer to telecom operators wherein the customer himself uses the telecom operator's facility/hardware/software.

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[5] Vodafone South Ltd. v. DDIT [2015] 53 taxmann.com 441 (Ban)
[6] Verizon Communications Singapore Pvt. Ltd. v. ITO [2013] 263 CTR 497 (Mad)

- Accordingly, the AAR held that the amount received by the applicant towards the solutions would not be in the nature of royalty.

Permanent Establishment

- The applicant contended that it does not have PE in India as per provisions of Article 5 of the India-US treaty. A U.S. tax resident can have a PE in India if, *inter-alia*, it has a fixed place of business through which its business is wholly or partly carried on or it carries on business through an agent in India other than an agent of independent status.

- The applicant does not have an office or any other establishment in India, and neither does it have any employees hired in India not do its personnel/employees visit India for the purpose of the provision of services to the Indian subscribers.

- Further the reseller agreement does not create a principal-agent relationship between the applicant and the reseller. The relationship is established is that of independent contractors, neither party has power to direct or control the day-to-day activities of the other.

- Akamai India concludes contracts in its own name, and it does not maintain any stock of goods of the applicant. It purchases the Akamai solutions from the applicant for onward sale to Indian customers; secures orders and enters into contract with customers in India on its own account and not on behalf of the applicant. Their relationship is on a principal-to-principal basis. Hence none of the conditions enumerated in Article 5(4) of the tax treaty are satisfied.

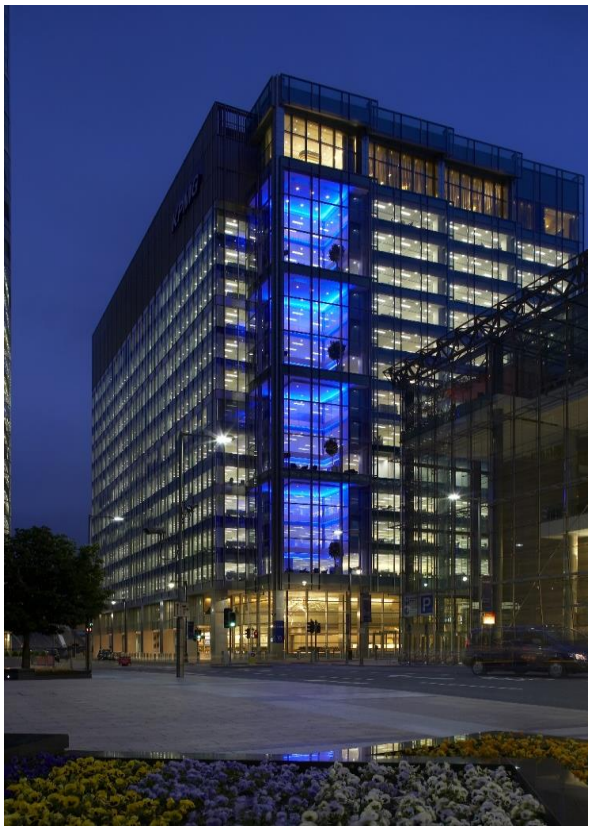
- The tax department has argued that the applicant's income was taxable as FTS/FIS or royalty in India. No submissions or arguments have been made to the effect that the applicant has a PE in India. In any case, once it has been ruled above that income does not accrue or arise in the hands of the applicant as royalty or FTS/FIS, under the Act or under the tax treaty, the question of existence of a PE under Article 5 of the tax treaty becomes irrelevant and academic, as no income can be attributed to it, if at all there was one.

- The applicant does not have a PE in India. However, since the question of a PE coming into existence is a fact based finding, in the case of any facts changing in future, with regard to the inter se relationship between the applicant and Akamai India, such as to impact any of the clauses mentioned in the tax treaty, the tax department would be free to examine the same.

Our comments

Whether the payment to foreign companies for providing the content delivery solutions for accelerating content and business processes online is FTS/royalty was an issue before the AAR. Relying on the various decisions and referring to the agreement between the applicant and the Indian company, the AAR held that such payment is not taxable as royalty or FTS under the Act or the tax treaty.

The AAR also dealt with the Copyright Act and observed that the said Act does not apply to the transaction in the instant case since the applicant does not act or provide rights to act in any work which involves any computer or any copy of the computer software.



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Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Maruthi Info-Tech Centre,
11-12/1, Inner Ring Road,
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers,
Ground Floor, 1, 2 & 3 Floor,
Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur – 302 018.
Tel: +91 141 – 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi, Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus,
36/3-B, Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200