

TAX FLASH NEWS

20 February 2017

Technology services provided in the form of data centre, infrastructure, connectivity and application technology are neither taxable as royalty nor as fees for technical services under the Income-tax Act

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Atos Information Technology HK Ltd.¹ (the taxpayer) held that the payment made to the taxpayer for providing of technology services in the form of data centre, infrastructure, connectivity and application technology is not taxable as 'royalty' under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act).

The taxpayer provided a standard facility for data processing without any human intervention. Accordingly, the said payment is not taxable as 'Fees for Technical Services' (FTS) under Section 9(1)(vii) of the Act.

Facts of the case

- The taxpayer is a non-resident company, engaged in the business of providing services/facilities for data processing through computer hardware and software from Hong Kong.
- The taxpayer entered into a contract for provision of computing services, for the provision of data process support to Standard Chartered Bank India (SCB India), engaged in banking business in India.
- Under the said contract, the taxpayer processed the data for SCB India in Hong Kong. The said services were provided by the taxpayer to SCB since August, 2005. The contract for computing services was governed by a 'Cocteau agreement' dated 12 February 2004 which the taxpayer had entered with SCB worldwide for the provision of data processing support to SCB in 68 countries during the years under consideration.
- Considering the involvement of 68 countries, the 'Cocteau agreement' typical of any other outsourcing contract contained detailed framework for providing adequate safeguards to SCB and the requisite services to be performed by the taxpayer at certain standards so as to meet the outsourcing objectives of SCB.
- The Assessing Officer (AO) observed that the taxpayer has not provided mere data processing services to SCB, but has also provided technology in the form of data-centre, infrastructure, connectivity and application technology for its banking operations.
- The taxpayer created and provided facility in the form of dedicated centres for exclusive use of SCB with disaster recovery facility and storage facility. Apart from the infrastructure facility, secure network connectivity is provided with modern technology support. The infrastructure facility in

¹ Atos Information Technology HK Ltd. v. DCIT (ITA No. 237,238,239 &240/MUM/2016) – Taxutra.com

the form of data centre, storage area network, disaster recovery facility and dedicated network connectivity is translated into functional process by defined service flow for the various geographic locations, for various business application, which would constitute ‘process’.

- The data computing services are performed on the above said platform utilising the above process. Thus, the taxpayer has made available to SCB the use of its equipment, model, design, invention and process and has also rendered services in connection with the same, and hence the nature of the transaction clearly falls within the purview of ‘royalty’, as defined in Explanation 2² to Section 9(1)(vi) of the Act.
- The AO after extensively relying on the ‘Cocteau agreement’ also held that the taxpayer has provided technical, managerial and consultancy services to SCB and such services clearly fall within the purview of technical services defined under Explanation 2 to Section 9(1)(vii) of the Act.
- The AO, thus relying upon the various provisions of ‘Cocteau agreement’ came to the conclusion that payment made by SCB to the taxpayer is to be taxed in India, both as ‘royalty’ as well as ‘FTS’.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal’s decision

- Since the taxpayer is incorporated in Hong Kong and is providing services/facilities for processing data to SCB India from Hong Kong, the payment made by SCB India to the taxpayer has to be seen from the perspective of the Act and not under any tax treaty.

Taxability of ‘royalty’

- The main objective of the ‘Cocteau agreement’ is to provide SCB group all across the world, processing of data through a network of computer systems in Hong Kong. In the entire agreement there is no whisper of any

technology transfer or application of technology *per se* to SCB. This is a kind of outsourcing activity which has been given by SCB to the taxpayer to process its data from various branches across the country. The reference to the various details in the agreement is merely to ensure quality, standard and various safeguards which are to be adopted in the course of processing data especially looking the volume of data required to be processed from all around the globe.

- There is no providing or giving any use or right to use of any process to SCB. The technology, infrastructure, data centre, connectivity, etc. is solely used by the taxpayer for its own purposes and not to make available any such thing to SCB.
- With respect to the various stages of processing of data, the Tribunal observed that there was no use or right to use of any process which is given or made available to SCB. Further, there is absolutely no use of equipment also as alleged by the tax department within the definition given in clause (iva) of Explanation 2 to Sec. 9(1)(vi) of the Act. The said clause deals mainly with the ‘use’ or ‘right to use’ any industrial, commercial or scientific equipment and applies only to income from leasing of such industrial, commercial or scientific equipment. The same is borne out from the Memorandum to the Finance Bill, 2001, through which the said clause was inserted with effect from 1 April 2002, and same proposition is also held by Tribunal in Yahoo India P. Ltd.³ In the taxpayers case, there is no income from leasing of any equipment. The legislature thus, has clearly envisaged that clause (iva) of Explanation 2 to Section 9(1)(vi) of the Act is to cover lease rent of industrial, commercial and scientific equipment in the definition of royalty and the said definition has been widened to that extent only.

² Explanation 2 to Section 9(1)(vi) of the Act defines the term ‘royalty’.

³ Yahoo India (P.) Ltd. v. DCIT [2011] 140 TTJ 195 (Mum).

- Explanation 6 to Section 9(1)(vi) of the Act enlarges the scope of 'process' to include transmission by satellite cable, fibre optic, etc. Explanation 5 to Section 9(1)(i) of the Act is applicable where consideration is of any right, property or information as defined in clauses (i) to (v) of Explanation 2 only and not in clause (iva) for the reason that Explanation 5 has been inserted with retrospective effect from 1 June 1976. In other words, Explanation 5 has been inserted retrospectively from the birth of Section 9(1)(vi) of the Act to clarify the intention behind the legislation. Explanation 5 to Section 9(1)(vi) of the Act is to be read with the Section 9(1)(vi) which was there on the statute as on 1 April 1976. Whereas clause (iva) to Explanation 2 of Section 9(1)(vi) of the Act was inserted from April 1, 2002. Thus, retrospective effect of the said clause cannot be deemed from 1 June 1976 and hence it cannot be held that Explanation 5 also applies to the said clause as this clause never existed as on 1 April, 1976 and accordingly, the legislation cannot clarify the intention of the clause which never existed on the said date. Hence Explanation 5 & 6 would not be applicable in the case of taxpayer.
- There is absolutely no transfer of any technology, information, knowhow or any of the terms used in Explanation 2 to Section 9(1)(vi) of the Act or any kind of providing of technology in the form of data centre, infrastructure, connectivity and application technology by the taxpayer to SCB for SCB's banking operations. Thus, the payment made by SCB to the taxpayer does not fall within the realm of 'royalty' and hence cannot be taxed in India as royalty under Section 9(1)(vi) of the Act.

Taxability of 'Fees for Technical Services'

- The provision regarding services provided by the taxpayer to SCB is mainly a standard facility and there is no constant human endeavour or human intervention which is required to provide the data servicing service.

- Further, looking at the number of volume of transactions transmitted by SCB to the taxpayer, it would be impossible for any number of humans to apply their mind and generate reports. Thus, the magnitude of transactions undertaken by the taxpayer itself goes to show that the computer systems installed by the taxpayer in Hong Kong is a standard facility through which data is processed. Reliance was placed on decision of the Mumbai Tribunal in the case of Siemens Limited.⁴
- The Supreme Court in the case of Kotak Securities Ltd.⁵ held that if the services are provided through fully automated standard facility, the same cannot be reckoned as rendering of technical services as contemplated under Section 9(1)(vii) of the Act.
- In view of above facts, the payment made by SCB India to the taxpayer does not fall within the realm of 'FTS' as contained in Section 9(1)(vii) of the Act, and the taxpayer has only provided a standard facility for data processing without any human intervention. Accordingly, the said payment is not taxable in India as FTS in terms of Section 9(1)(vii) of the Act.

Our comments

The issue relating to taxability of technology services provided in the form of data center, etc. has been a subject matter of debate before the courts and Tribunal.

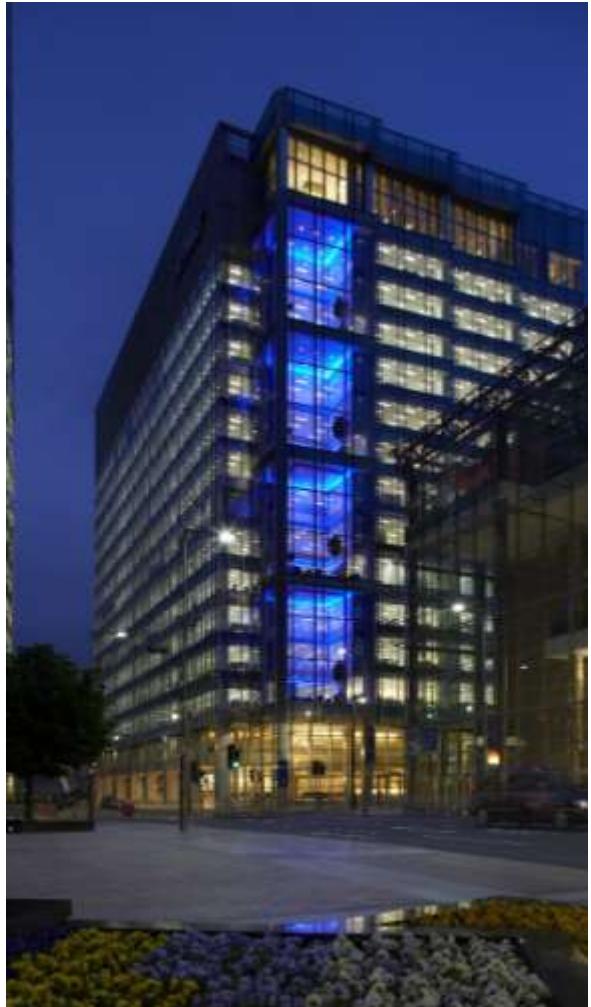
The Authority of Advance Ruling (AAR) in the case of Dell International Services (India) P. Ltd, held that the word 'use' in relation to equipment occurring in clause (iva) of explanation to Section 9(1)(vi) of the Act was not to be understood in the broad sense of availing of the benefit of an equipment. What was contemplated by word 'use' was that the customer came face to face with the equipment, operated it or controlled its

⁴ Siemens Limited v. CIT (Appeals) (ITA No. 4356/Mum/2010) (Mum)

⁵ CIT v. Kotak Securities Ltd. (Civil Appeal No. 3141 of 2016)

function in some manner. The Mumbai Tribunal in the instant case observed that there is absolutely no use of equipment as alleged by the tax department within the definition given in clause (iva) of Explanation 2 to Sec. 9(1)(vi) of the Act. Further it has also been observed that Explanation 5 to Section 9(1)(i) of the Act is applicable where consideration is of any right, property or information as defined in clauses (i) to (v) of Explanation 2 only and not in clause (iva) for the reason that Explanation 5 has been inserted with retrospective effect from 1 June 1976 and clause (iva) of Explanation with effect from 1 April 2002. Thus, retrospective effect of the said clause cannot be deemed from 1 June 1976 and hence it cannot be held that Explanation 5 also applies to the said clause as this clause never existed as on 1 April 1976 and accordingly, the legislation cannot clarify the intention of the clause which never existed on the said date.

On one hand there are decisions⁶ where it has been held that the services, similar to the ones dealt by the Tribunal in instant case, are taxable as 'royalty'/FTS'. On the other hand there are decisions⁷ where such services are not held as 'royalty'/FTS'. The Tribunal in the instant case has held that such services are not taxable as 'royalty'/FTS' under the Act.



⁶ Frontline Soft Ltd. v. DCIT [2007] 12 DTR 131 (Hyd); Cargo Community Network (P.) Ltd. [2007] 289 ITR 355 (AAR)

⁷ ADIT v. Antwerp Diamond Bank NV [2014] 65 SOT 23 (Mum); Standard Chartered Bank v. DDIT [2011] 45 SOT 494 (Mum)

www.kpmg.com/in

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.