Payment received for sale of online content delivery solutions from Indian reseller not taxable as royalty or FTS: AAR

Summary

The Authority of Advance Ruling (AAR) in a recent case[1] held that payments received by Akamai Technologies Inc (the taxpayer) from its Indian group company under the non-exclusive reseller agreement for sale of the taxpayer's online content delivery and business process solutions to customers in India were not taxable as Fees for Technical Services (FTS) or as royalty under the Income-tax Act, 1961[2] (the Act) as well as the India-US Double Taxation Avoidance Agreement[3] (DTAA). The AAR also held that such payments did not create a Permanent Establishment (PE) under the DTAA.

Facts of the case

- The taxpayer, a technology company incorporated in USA, is a leading global service provider for accelerating web content and business processes online.
- The taxpayer developed a product 'Akamai EdgePlatform' (Solution), which pulled content from the customer's web server by replicating the data therefrom and continually monitors the Internet-traffic, trouble spots and overall conditions. The end-users accessed the customer's website through the Solution for a faster browsing experience.
- The taxpayer entered into a 'services reseller agreement' (Agreement) with its group company (Akamai India) wherein Akamai India was appointed as a non-exclusive reseller authorised to resell the taxpayer's Solution directly to customers in India. Akamai India invoiced the Indian customers on its own account.
- As per the Agreement, Akamai India would not have any rights, title and interest in any intellectual property and software of the taxpayer, including the Solution.

[1] AAR 1107/2011_Akamai Technologies Inc
[2] As royalty under Explanation 2 to clause (vi) of section 9(1) of the Act and as FTS under section 9(1)(vii) of the Act
[3] Royalty under Article 12(3) and FIS under Article 12(4) of the DTAA

- The taxpayer sought an advance ruling on whether the payments received from Akamai India would qualify as royalty or FTS under the Act or the India-US DTAA. The taxpayer also sought a ruling on the constitution of a PE in India under the provisions of Article 5 of the DTAA.

The issue raised by the taxpayer along with the arguments submitted and the AAR's ruling are summarised as under:

Taxation as royalty under the Act and DTAA

Revenue's contention

- The transaction involved a transfer of right in copyright through which the taxpayer (the original copyright holder) had granted distribution rights for the Solution to Akamai India.
- The Agreement was in the nature of a licensing agreement which involved transfer of right in copyright. Akamai India got the licence to resell the Solution; the programme itself had not been sold to Akamai India.
- The transaction involved the grant of right to use the taxpayer's trademarks and brand features for the purpose of marketing and reselling the Solution by Akamai India.
- Revenue placed heavy reliance on the Karnataka High Court ruling in the case of Samsung Electronics[4] and a plethora of judgements to contend that the transaction amounted to grant of distribution rights, involving transfer of rights in the process, and hence it was in the nature of royalty.

Taxpayer's contention

- The taxpayer emphasised on the fact that it was a technology company and not a software distributor and that it did not grant any licence to distribute any software product in a manner that granted any copyright to Akamai India. Also, it did not pass on any copyright rights in any software at any point in time to either Akamai India or the end user.
- The Agreement did not grant or transfer any right in the 'process' nor was there any use of such process by Akamai India or the end user.

[4] CIT & Another v Samsung Electronics Co Ltd & Others (2011) 245 CTR (Kar) 481

- The taxpayer itself had exploited the right to use, operate or control its technology/intangibles without granting the right to use them to Akamai India/Indian customers. The customers/end users were not provided with any access to the taxpayer's infrastructure (neither software nor hardware) nor was such access even required for availing the standard facility provided by the taxpayer. Accordingly, the payments received were not for right to use any industrial, commercial or scientific equipment and thus cannot constitute 'royalty'.

AAR's decision

- **Applicability of the Copyright Act**

– The AAR opined that the essence of the Agreement was not for a computer programme but rather for a facility that was provided by the taxpayer to the customers, using the taxpayer's own private network. Hence, the entire provisions of the Copyright Act did not apply to the transaction.

- **On 'use of'/'right to use' trademark**

– Rejecting the Revenue's contentions, the AAR held that grant of distribution rights by the taxpayer did not involve grant to use 'trademark' as there was no intention of use of trademark per se by Akamai India.

- **On grant or transfer of right in the 'process'**

– It was observed that the Agreement nowhere entailed any grant or a transfer of right in the 'process' nor was there any use of 'process' as was required under the DTAA. The AAR further observed that if at all there was a 'process' which was 'used', it was by the taxpayer itself to render the outsourced infrastructure services to the end user.

– **On 'equipment royalty'**

It was held that since the equipment was used by the taxpayer itself to provide the Solution to Akamai India which was re-sold to the India customers, and Akamai India/Indian customers were not granted any right to use any equipment, the transaction was not covered under the definition of 'royalty'.

Taxation as FTS under the Act and DTAA

- The AAR held that the payment for the Solution provided by the taxpayer could not be treated as FTS under the Act because of the following:

- The taxpayer provided a standard facility to all customers alike, for accelerating the delivery of their content, irrespective of the nature of business/website content. Therefore, such service could not be termed as a specialised, exclusive and individual requirement of the customer so as to qualify as 'technical services'.
- The human involvement in the taxpayer's case was only in relation to the development of the Solution and for marketing and after sale services, and not while rendering of the Solution to Akamai India or the customer/end-user. Therefore, the Solution provided by the taxpayer without human intervention cannot be treated as provision of 'technical services'.

- The AAR held that the Solution would not qualify as 'FIS' under the DTAA since the Solution provided by the taxpayer did not provide Akamai India/customer/end user with any technical knowledge, skill etc which enabled them to apply such technology on their own in future without recourse to the taxpayer.

Constitution of PE

- The AAR held that the taxpayer did not have a PE in India based on the following facts of the case:
  - The Agreement did not create a principal-agent relationship between the taxpayer and Akamai India; neither party had power to direct or control the day-to-day activities and the relationship established was that of independent contractors.
  - Akamai India concluded contracts in its own name; it did not maintain any stock of goods of the taxpayer; it purchased the Solution from the taxpayer for onward sale to Indian customers; it secured orders and entered into contract with customers in India on its own.
- The AAR also held that the question of PE coming into existence was a fact-based finding and the tax officer would be free to examine the issue afresh in case of any subsequent change in facts inter se between the taxpayer and Akamai India.

Our comments

The ruling carves out an interesting and a much-needed distinction between sale of computer software and sale of online technology based services in a digital economy. It provides a welcome clarity on the taxability of provision of online services.

The AAR ruled that the access did not result in process, equipment or patent/copyright royalty (even under the Act). It also observed that it did not result in FTS as ‘facility’ needed to be distinguished from ‘services’ and where there was no human intervention, there should not be a provision of service (even under the Act). Hence, on general principles itself, the characterisation as ‘royalty’ and ‘FTS’ has been discarded.

Interestingly, in India, provision of various online services such as maintenance of website/participative online networks has been proposed to be covered under the equalisation levy by the Committee on Taxation of e-commerce. However, as of now equalisation levy applies to only online advertising.

Contact us

To know more, please visit **www.grantthornton.in** or contact any of our offices as mentioned below:

NEW DELHI	NEW DELHI	AHMEDABAD	BENGALURU	CHANDIGARH
National Office Outer Circle L 41 Connaught Circus, New Delhi 110001 T +91 11 4278 7070	6th floor, Worldmark 2, Aerocity, New Delhi – 110037 T +91 11 4952 7400	7th Floor, Heritage Chambers, Nr. Azad Society, Nehru Nagar, Ahmedabad - 380015	5th Floor, 65/2, Block A, Bagmane Tridib, Bagmane Tech Park, C V Raman Nagar, Bengaluru – 560093 T+91 80 4243 0700	B-406A, 4th Floor, L&T Elante office Industrial area, Phase-I Chandigarh 160002 T +91 172 4338 000

CHENNAI	GURGAON	HYDERABAD	KOCHI	KOLKATA
7th Floor, Prestige Polygon 471, Anna Salai, Teynampet Chennai - 600 018 T +91 44 4294 0000	21st Floor DLF Square, Jacaranda Marg, DLF Phase II, Gurgaon 122002 T +91 124 462 8000	7th Floor, Block III White House Kundan Bagh, Begumpet Hyderabad 500016 T +91 40 6630 8200	7th Floor, Modayil Centre Point, Warriam road junction, M.G. Road Kochi 682016 T +91 484 406 4541	10C Hungerford Street 5th Floor, Kolkata 700017 T +91 33 4050 8000

MUMBAI	MUMBAI	NOIDA	PUNE
16th Floor, Tower II Indiabulls Finance Centre SB Marg, Elphinstone (W) Mumbai 400013 T +91 22 6626 2600	9th Floor, Classic Pentagon, Nr Bisleri, Western Express Highway, Andheri (E) Mumbai 400099 T +91 22 6176 7800	Plot No. 19A, 7th Floor Sector – 16A, Noida 201301 T +91 120 7109 001	3rd Floor, Unit No 309 to 312, West Wing, Nyati Unitree Nagar Road, Yerwada Pune- 411006 T +91 20 6744 8800

For more information or for any queries, write to us at **contact@in.gt.com**

Follow us @GrantThorntonIN

Grant Thornton
An instinct for growth™