



## Web-hosting services provided by a foreign company are not taxable as royalty in India

### Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Savvis Communication Corporation<sup>1</sup> (the taxpayer) held that web-hosting services provided by a foreign company are not taxable as royalty in India. The Tribunal observed that payment for providing web-hosting service, though with the help of sophisticated scientific equipment, is not a consideration for use of scientific equipment when the person making the payment does not have an independent right to use such an equipment and physical access to it. Even though the services rendered by the taxpayer to the Indian entities may involve use of certain scientific equipment, the receipts by the taxpayer cannot be treated as a 'consideration for the use of, or right to use of, scientific equipment,' which is a 'sine qua non'<sup>2</sup> for taxability under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act).

### Facts of the case

- The taxpayer is a U.S.-based company, engaged in the business of providing information technology solutions, including, web hosting services. During the relevant financial period, the taxpayer earned income from the provision of managed hosting services to some Indian entities.
- In the income-tax return filed by the taxpayer, the income so earned was disclosed but claimed to be not taxable in India. It was claimed that income is not taxable in India as Fees for Included

Services (FIS) under Article 12 of the tax treaty, and it could also not be taxed under Article 7, as the taxpayer did not have any Permanent Establishment (PE) in India as per Article 5 of the tax treaty.

- The Assessing Officer (AO) was of the view that income received by the taxpayer was for granting the right to use the scientific equipment which was taxable in India under clause (va) of Explanation 2 to Section 9(1)(vi) of the Act as well as under Article 12(3) (b) of the tax treaty.
- The Commissioner of Income-tax (Appeals) [CIT(A)] following decisions of coordinate benches of this Tribunal held that providing web hosting services, with all backup, maintenance, security and uninterrupted services does not amount to royalty under the provisions of the Act or the tax treaty.

### Tribunal's ruling

- When the taxpayer receives an income on account of allowing a customer to use a scientific equipment, it does become taxable for the reason of its being characterised as such. However, the use of a scientific equipment by the taxpayer, in the course of giving a service to the customer, is something very distinct from allowing the customer to use a scientific equipment.

<sup>1</sup> DDIT v. Savvis Communication Corporation [I.T.A. No. 7340/Mum/2012, Assessment years: 2009-10] – Taxsutra.com

<sup>2</sup> Sine qua non - an indispensable condition

- The true test is in finding out the answer to the fundamental question- is it the consideration for the rendition of services, even though involving the use of scientific equipment, or is it the consideration for use of equipment simpliciter by the taxpayer? In the former case, the consideration is not taxable, whereas, in the latter case, the consideration is taxable.
- In the case of Kotak Mahindra Primus Ltd.<sup>3</sup>, a coordinate bench, dealt with a situation in which the mainframe computer and the specialized software was used for rendering data processing services to an Indian entity. In that case, it was observed that no part of the payment can be said to be for the use of specialized software on which data is processed or for the use of mainframe computer because the Indian company does not have any independent right to use the computer or even physical access to the mainframe computer, so as to use the mainframe computer or the specialized software.
- Payment cannot be said to be the consideration for use of scientific equipment when the person making the payment does not have an independent right to use such an equipment and physical access to it.
- In the present case, the taxpayer is providing web-hosting service, though with the help of sophisticated scientific equipment, in the virtual world. The scientific equipment used by the assessee enable rendition of such a service, and such use, which is not even by the Indian entity, is not an end in itself.
- Accordingly, even though the services rendered by the taxpayer to the Indian entities may involve use of certain scientific equipment, the receipts by the taxpayer cannot be treated as 'consideration for the use of, or right to use of, scientific equipment,' which is a sine qua non for taxability under section 9(1)(vi) of the Act.

## Our comments

In the present case, the Mumbai Tribunal has held that payment for providing web-hosting service, though with the help of sophisticated scientific equipment is not a consideration for use of scientific equipment since the person making the payment does not have an independent right to use such an equipment and physical access to it. Therefore, such payment was not taxable as royalty.

The Mumbai Tribunal in the case People Interactive (I) P Ltd.<sup>4</sup> held that payments for website hosting cannot be treated as royalty under the Act or under the India-U.S. tax treaty. The taxpayer could not operate or even does not have physical access to the equipment. Further, the taxpayer is not using equipment but only availing the services provided by a non-resident. Therefore, such payments cannot be treated as royalty under the Act or under the India-US tax treaty.

<sup>3</sup> Kotak Mahindra Primus Ltd v. DDIT [2007] 11 SOT 578 (Bom)

<sup>4</sup> ITO v. People Interactive (I) P Ltd [ITA Nos. 2180, 2179, 2181, 2182, dated 29 February 2012] – Taxsutra.com

[www.kpmg.com/in](http://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

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