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India | Tax & Regulatory | For private circulation only | 30 March 2017

Global Business Tax Alert

Sharp Insights

The Mumbai Tribunal in the case of Atos Information Technology HK Ltd. v. DCIT (I.T.A. No. 237-240/Mum/2016), held that payments received by the taxpayer for data processing support through a network of computers systems in Hong Kong is not taxable as royalty under section 9(1)(iv) of the Income Tax Act ('the Act') or as Fees for Technical Service ('FTS') under section 9(1)(vii) of Act.

Issue no: GBTA/25/2017

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Background

- 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 had entered into a contract for provision of computing services, for the provision of data process support to Standard Chartered Bank India ('SCB'), which is engaged in banking business in India.
- Under the contract, the taxpayer processed data for SCB in Hong Kong. The input data was fed by SCB India users via their workstations in India and transmitted to the taxpayer data centre in Hong Kong. The taxpayer does not supply or install any hardware or software in the premises of SCB India. The transactions/ data are processed in the data centre of the taxpayer in Hong Kong. The processed data is transmitted electronically to SCB India. A copy of the data is backed up and stored in the Hong Kong Centre for recovery purposes.
- The said services were provided by the taxpayer to SCB since August 2005. Considering the involvement of 68 countries, the agreement 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 is not only providing data processing services to SCB, but is also providing technology in the form of data centre, infrastructure, connectivity and application technology for SCB's banking operations. The AO further contended that the taxpayer has created and provided facility in the form of dedicated centres for exclusive use of SCB with disaster recovery facility and storage facility.
- This infrastructure facility is translated into functional process by a defined service flow for various geographic locations and for different business applications, which would constitute "process". Accordingly such transactions shall qualify as being in the nature of "royalty" as defined in Explanation 2 to Section 9(1)(vi) of the Act.
- Further, the taxpayer has also provided technical, managerial and consultancy services to SCB, which clearly falls within the nature of technical services defined in Explanation 2 to section 9(1)(vii) of Act.
- On appeal, Commissioner of Income Tax (Appeals) [CIT(A)] upheld the order of the AO.
- Aggrieved by the order of the CIT(A), the taxpayer preferred an appeal with the Tribunal.

Ruling of the Tribunal

- As the taxpayer is from Hong Kong, the payment made to the taxpayer has to be seen from the perspective of the Act and not under any tax treaty, in the absence of a tax treaty with Hong Kong.

Royalty

- The Tribunal observed that the main objective of the agreement was to provide processing of data through a network of computer systems in Hong Kong. There was no technology transfer or application of technology in the agreement. Further, the Tribunal observed various stages of data processing and observed that the reference to the various details in the agreement are merely to ensure quality, standard and various safeguards which are to be adopted in the course of processing data, especially looking at the volume of data required to be processed from all around the globe.
- There is no provision of or giving any use or right to use of any process to SCB. The technology, infrastructure, data centre, etc. was solely used by the taxpayer for its own purposes and not to make available any such thing to SCB. Further, there was no 'use' or 'right to use' any industrial, commercial or scientific equipment.
- The Tribunal further observed that the Explanation 5 to section 9(1) (vi) of the Act (in respect of any right, property or information) and Explanation 6 to section 9(1) (vi) of the Act, enlarging the scope of process to include transmission by satellite, cable, fibre optic etc. relating to use or right to use any industrial, commercial or scientific equipment were inserted by Finance Act 2012 to be applicable with a retrospective effect from 1 June 1976. However, the clause (iva) pertaining to the use or right to use any industrial, commercial or scientific equipment was inserted from 1 April 2002. Therefore, relying on the decision of Mumbai Tribunal[1], it was held that Explanation 5 and 6 cannot be applicable to the taxpayer since that clause did not exist as on 1 April 1976.
- The Tribunal also observed that there is absolutely no transfer of any technology, information, know-how or any of the terms used in Explanation 2 or any kind of provision of technology in the form of data centre, infrastructure, connectivity and application technology by the taxpayer for SCB's banking operations.
- Accordingly, the Tribunal held that the payment made by SCB to the taxpayer does not fall within the definition of royalty and hence cannot be taxed in India as royalty.

FTS

- As regards FTS, the Tribunal observed that the services provided by taxpayer to SCB is mainly a standard facility and there is no constant human endeavour or human intervention which is required to provide the service.
- The Tribunal also observed that looking at the number of volume of transactions transmitted by SCB to the taxpayer, it would be impossible for any number of persons to apply their mind and generate reports. Considering the magnitude of transactions undertaken, it substantiates the fact that it is standard facility through which data is processed.
- The Tribunal relied on the decision of Supreme Court[2] and Mumbai Tribunal[3] wherein it was held that where there is no human intervention for rendering of technical services it cannot be considered as FTS.
- Accordingly, the Tribunal held that the payment made by SCB does not qualify to be in the nature of FTS and therefore the payment is not taxable.

[1] Yahoo India P. Ltd v DCIT (140 TTJ 195)
[2] M/s Kotak Securities (340 ITR 333)
[3] Siemens Limited v CIT (ITA No. 4356/Mum/2010)

Conclusion

The Tribunal held that payments made to the taxpayer in respect of technology services provided in the form of data centre, infrastructure, connectivity and application technology are not in the nature of royalty or FTS as defined under section 9(1)(vi) and 9(1)(vii) of the Act and therefore not taxable.

It is a welcome ruling since even after considering the insertion of Explanations 5 and 6 to section 9(1)(vi) of the Act, the data processing services have been held as not taxable under the Act as royalty.

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