AAR rules that income earned under non-exclusive reseller agreement for rendering technology services is neither taxable as FIS nor as royalty

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In brief

Recently, the Authority for Advance Rulings (AAR) has held that payments received by the applicant[1] for providing technology services (i.e. accelerating content and business processes online) on automatic and continuous basis through the use of software and servers from its Indian affiliate under a non-exclusive reseller agreement does not tantamount to fee for technical services/ fees for included services (FTS/FIS) or royalty both under the Income-tax Act, 1961 (the Act) and the India-US Double Taxation Avoidance Agreement (tax treaty).

In detail

Facts

- The applicant, a US-based technology company, was engaged in accelerating content and business processes online solutions (services). It catered to customers who had web-based applications/ websites, etc., on the internet.
- The applicant helped its customers in delivering web content faster and more reliably.
- For this purpose, the applicant had built its own platform which pulled the content from the customer's web server by replicating data therefrom and continually monitored internet-traffic, troubleshooting and overall conditions. The end-users accessed the customer's website through that platform.
- To sell these services in India, the applicant entered into a non-exclusive reseller arrangement (RA) with its group affiliate in India.
- The key terms of RA were as follows:
  - The Indian affiliate resold services by directly entering into contracts with customers in India;
  - The Indian affiliate was required to dedicate adequate resources and staff;
  - The Indian affiliate had no right, title and interest in any intellectual property (IP) and software of the applicant, including the platform; and
  - The Indian affiliate would pay a fee to the applicant to purchase the services.
- The applicant filed an application with the AAR to determine if the payment received from its Indian affiliate was taxable in India, and thus, subject to Indian withholding tax.

[1] AAR No. 1107 of 2011

Issues before the AAR

- Whether the payments received by the applicant under the RA for providing the content delivery services would fall within the meaning of FTS or royalty under the Act or the tax treaty?
- Whether a Permanent Establishment (PE) had been created by the applicant in India?

Applicant's contentions

- The services provided were in the form of a standard facility and the platform ran automatically on a continuous basis for any customer who was willing to pay for such facility. The services were neither specialised/ exclusive to the individual customer's requirement.
- The platform provided standard facilities and worked without human intervention.[2]
- Further, the services did not "make available" any technological knowledge, skill, etc., to the customers in India.
- Hence, the income earned in India should not have been construed as FTS/ FIS both under the provisions of the Act and under the tax treaty.
- The dominant intention of the RA was only to provide the end-users with fast and secure internet access and did not contemplate any use or right to use trademarks/ transfer of IP by the Indian affiliate.
- Therefore, the services provided could not be construed as royalty both under the Act or the tax treaty.
- It did not have an office or any other establishment in India or employees in India for provision of services in India. In addition, the RA did not create a principal-agency relationship between the applicant and its Indian affiliate. Therefore, it did not created a PE in India.

Revenue's contentions

- In this technological era, the presence of humans for rendering services was not required and the development of such software and solutions could not have happened without human involvement.
- The applicant required the technical expertise and setup to perform the services that it makes available to Indian customers either through its Indian affiliate or sometimes even directly. Hence, the amount received by the applicant should have been regarded as FTS/ FIS.
- The RA was in the nature of a licensing agreement in which the applicant, being the copyright holder, transferred the right in copyright.
- The RA involved the right to use trademarks and the brand name, as it allowed the Indian affiliate to use them for marketing and reselling the services.
- The RA involved transfer of distribution rights, involving the transfer of rights in process. Hence, the applicant received such income that was in the nature of royalty.

AAR's ruling

FTS/ FIS

- The services provided by the applicant did not constitute technical services, as the applicant provided a standard facility without any human intervention. Hence, the case was outside the scope of FTS, as defined in Explanation 2 to clause (vii) of section 9(1) of the Act.
- Further, such services provided by the applicant only enabled faster content delivery of the customer's website without providing any technical knowledge/ skill to enable Indian affiliate/ customers to apply such services on their own. Hence, the "make available" under the tax treaty was not satisfied.

Royalty

- The Indian affiliate/ customers should have fulfilled the essential condition of "use" or "right to use" any equipment, copyright (i.e. software), process, trademark, brand name, etc., to qualify as royalties.
- The RA entered into by the applicant intended to provide a global, secure and outsourced infrastructure facility and not any type of software to the Indian affiliate/ customers. Hence, such business model of the applicant was very different from that of a normal software reseller/ distributor.
- The applicant used this equipment itself to provide services to its Indian affiliate, and such services were then resold to Indian customers. The arrangement merely enhanced the performance of the customers' websites. Although the services may be provided using tangible properties, such as servers, databases, etc., the Indian affiliate/ Indian customers did not have possession and control over the platform/ website/ server/ any tangible

[2] Relied on CIT *v.* Kotak Securities Limited [2016] 383 ITR 1 (SC), and Skycell Communications Limited *v.* DCIT [2001] 251 ITR 53 (Madras)

property used in the provision of the services.

- The conduct of the parties, the business model and various agreements with end customers did not show any intention of use of trademark by the Indian affiliate for which payment had been made to the applicant.
- The RA did not entail any grant or transfer of right in the "process," nor was there any use of "process" as was required under the Act or the tax treaty. If at all there was a process "used," it was by the applicant itself to render the outsourced infrastructure services to the end-user.
- Accordingly, the receipt by the applicant could not be said to be royalty both under the Act or the tax treaty.

PE

As the Revenue had not made any submission or argument regarding the existence of PE, the AAR allowed the Revenue to examine the same at a later point of time.

The takeaways

- This is a welcomed ruling for technology companies who provide solutions through RA. Through this ruling, it is now settled that reselling of solutions through a RA cannot fall within the meaning of FTS/ FIS/ royalty.
- The AAR upholds that reselling of solutions as a standard facility without human intervention cannot be regarded as FTS/ FIS both under the Act and the tax treaty.
- The technology service provided to an Indian reseller under a non-exclusive reseller arrangement does not tantamount to royalty.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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