IN THE INCOME TAX APPELLATE TRIBUNAL, 'C' BENCH, PUNE

BEFORE SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER AND SHRI G.D. PADMAHSHALI, ACCOUNTANT MEMBER

ITA No. 596/PUN/2017 : A.Y. 2013-14

Balasai Net Pvt. Ltd.,
202, 1145 Pranita society
F.C. Road, Opp. Police Ground
Shivajinagar, Pune-411 016
PAN: AABCB4199998 Appellant

Vs.

The dy. C.I.T Circle 1(1), Pune. Respondent

Applicant by : Shri Pramod Shingte
Respondent by : Shri Suhas Kulkarni

Date of Hearing	:	28-02-2023
Date of Pronouncement	:	02-03-2023

ORDER

PER SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

This appeal preferred by the assessee emanates from order of the ld. CIT(A) - 1, Pune, dated 14-10-2016 for A.Y. 2013-14 as per the following grounds of appeal.

"1) On the facts and circumstances of the case and in law the Ld. CIT(A) was not justified in confirming the order of the A. O. by dismissing the appeal of the assessee holding that after amendment of the provisions of S. 9(1)(v),(vi) and (vii) the applicability of the provisions of S. 195 and S. 40(a)(i) is not dependent upon whether Non-resident had a PE in India or not and the income of the Non-resident is taxable in India. The decision of the Ld. CIT(A) is contrary to the provisions of law in the matter. The order of the Ld. CIT(A) be set aside.

2) On the facts and circumstances of the case and in law the provisions of S. 9(1)(v), (vi), (vii) are not applicable to the facts of the case and any payment made to non-resident whose income is not taxable in India in view of particular DTTA with the said country outside India, the provisions of S. 40(a)(i) become inapplicable. The Ld. CIT(A) was not justified in dismissing the appeal of the assessee on this issue: The order of the Ld. CIT(A) be set aside.

3) On the facts and circumstances of the case and in law and as held by Hon'ble Supreme Court in GE India Technology case (2010) 44 DTR 201(SC) the provisions of S. 195 which was interpreted to mean the words "chargeable under the provisions of the Act" and the payer is bound to deduct tax at source only if the sum paid is assessable to tax in India which is not possible if the payee has no P. E. in India. The payee has no PE in India and hence the income of the Non-resident is not taxable in India. The issue was not decided correctly by Ld. CIT(A). The appeal order be set aside.

2. The relevant facts in this case are that the assessee is a domestic company in which public is not substantially interested and the assessee is engaged in the business of providing web hosting, mailing solutions, server collection, providing virtual dedicated servers, cloud computing, server management and server security, etc. That, on verification of expenses, it was found by the ld. A.O that the assessee has incurred an amount of Rs. 30,90,448/- against payment for the following services received.

Name of the party	Nature of payment	Amount paid
Softlayer Dutch Holdings BV	Hosting charges	26,10,173.95
McAfee	Email Defence Services	3,38,601.15
Alt-N Technologies Inc.	Email server software	1,41,674.28

3. It was further revealed that the assessee has not deducted TDS against such payment. The A.R. of the assessee was asked to furnish reasons for nondeduction of TDS along with details of such expenses. In response, the assessee submitted ledger of such expenses and stated that the payment has been made to foreign based company having no permanent establishment in India and therefore, the provisions of TDS is not applicable on such payment. The submissions made by the assessee did not find favour with the A.O and as per para 4.1 and 4.2 the ld. A.O held that as per section 9 of the Income-tax Act, 1961 (hereinafter referred to as the “Act”) r.w.s. 40(a) of the Act, after the amendment by the Finance Act, 2012 with Explanation to sec. 9 gives a clear intention of the Legislature that for the purposes of section 9 which deals with income deemed to accrue or arise in India u/s 9(1)(v), (vi) and (vii) of the Act such income shall be included in the total income of the non-resident

whether or not the non-resident has a residence or place of business or business connection in India and the non-resident has rendered services in India. Therefore, the object is to levy tax on the income of non-resident if it has accrued or arisen in India and one such income is the income from royalty and fee for technical services and therefore, the concept of whether it has got any permanent establishment in India has no role to play in deciding the applicability of TDS provision in respect of payment to such non-resident. The ld. A.O further held that the I.T. services rendered through server by the assessee is imbibed in the right to use which is inherent and therefore, it falls within the definition of fees for technical services both under the Act as well as tax treaty. It was also held by the ld. A.O that server charge is also a type of services where the right to use is inherent and thus fall in the definition of royalty. Therefore, consideration is taxable as royalty both under the Act as well as tax treaty. Therefore, charge paid for server usage is in the nature of fees for technical services as well as royalty and there is no requirement of P.E for the applicability of TDS and that the assessee has also received services in India. As the TDS was not deducted u/s 195 of the Act, therefore, such payment was inadmissible u/s 40(a) of the Act, the ld. A.O made a total disallowance of Rs. 30,90,448/- on all the above payments and added to the total income of the assessee.

4. The ld. CIT(A) on this issue held as follows:

"I have considered the facts of the case as well as reply of the appellant. After amendment/substitution of Explanation to section 9 of the I.T. Act, 1961 vide Finance Act 2012, the provisions of sec. 9 have been very clear that for the purpose of section 9(1)(v)(vi) & (vii) of the Act, such income is required to be included in the total income of the non-resident, whether or not the non-resident has a reference or place of business or business connection in India and the non-resident has rendered services in India. This being so, amount in question is very much taxable, since the services have been rendered in India. The appellant has relied upon detail case laws but the same being prior to amendment in the explanation vide Finance Act, 2012, no support can be derived

by the appellant from those case laws. The A.O has discussed the issue in detail and I do not find any infirmity in the order of the AO in this regard. Accordingly, ground No. 1 to 3 are dismissed."

5. At the time of hearing, the ld. A.R for the assessee vehemently contended that disallowance has been made by the Department considering only section 9 with Explanation 5 as amended by the Finance Act, 2012, w.e.f. 1-4-2012 r.w.s. 40(a) and section 195 of the Act. However, the ld. A.O has failed to analyse the applicability of DTAA between India and Netherland defining term "royalty" as per Article 12 of such DTAA. The provision of DTAA shall apply to the case of the assessee which has the over-riding effect on the normal provisions of the Act. In this regard, it was further contended that section 9 of the Act is a deeming provision where income deemed to accrue or arise in India is made subject to tax. Clause

(vi) of the said section defines income by way of royalty payable as follows:

"Sec. 9(1))(vi) income by way of royalty payable by –

(a) the Government;

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India;

The Explanation 5 of the said provision reads as follows:

Explanation 5 – For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not.

……..

Clause (c) the location of such right, property or information is in India."

6. Reading section 9 clause (vi) along with Explanation 5 it is clear if it is a payment of royalty, then Explanation 5 clause (c) states that whether or not the location of such right, property or information is in India that won"t" affect the applicability of such royalty to be taxed in India. Now, according to the ld. A.R. as per article 12 of the DTAA between India and Netherland where definition of royalty is given, the assessee does not fall in such definition and therefore, there is no obligation on the part of the assessee for deduction of TDS. For the sake of completeness Article 12 of the DTAA is extracted as follows:

"[1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other contracting State may be taxed in that other State.]

[2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficial owner of the royalties, or fees for technical services, the tax so charged shall not exceed 10 percent of the gross amount of the royalties or the fees for technical services]

3. The competent authorities of the States shall by mutual agreement settle the mode of application of paragraph 2.

[4. The term „royalties" as used in this article means payments of any kind received as a consideration for the use of or the right to use, any copy right of literary, artistic or scientific work including cinematograph film, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.]

5. For purposes of this Article, „fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personal) of such services;

(a) are ancillary or subsidiary to the application of enjoyment of the right, property or information for which a payment described in paragraph4 of this Article is received or
(b) make available technical knowledge, experience. Skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design."

7. The ld. A.R further stated that royalty means the payment of any kind for the use of any copy right, etc. trademark, design, so the assessee is not falling in any of such head specified in the definition of royalty. The assessee"s business is done through the use of server and whatever data and software packages is stored through that server and even the clients of the assessee

gets to access that data through server itself. In such modus operandi there is no right to use of copy right, trademark, etc. Therefore, as per DTAA the payment made by the assessee does not fall within the definition of royalty or fees for technical services and therefore, the ld A.O was not correct in holding such payment as royalty and binging it within the applicability of TDS provision of the Act. The ld. A.R further submitted that the ld. CIT(A) while upholding the decision of the ld. A.O has also not dealt with the provision of DTAA between India and Netherland specifically the definition of royalty and whether the assessee is covered by the definition or not, nothing has been brought out in the findings of the ld. CIT(A).

8. Per contra, the ld. D.R brought to our notice an agreement with Softlayer Technology Inc., which is annexed in the paper book from pages 292 onwards and at page 313, the trademark terms are laid out. The ld. .D.R vehemently submitted that as per section 3 and sec. 4 of the said agreement as per Exhibit „A, the trademark terms, the owner of trademark is Softlayer. The assessee herein on entering an agreement with Softlayer gets the right only to use the trademark, but the exclusive ownership of such trademark is with Softlayer. If this fact is read into the definition of royalty as per Article 12 of DTAA between India and Netherland which defines royalty means the payment of any kind received as consideration for the use of right to use, any copy right, patent, trademark, etc., therefore, as per the agreement with Softlayer when the assessee is using the trademark which is owned by Softlayer then that right to use the trademark will fall in the definition of royalty and accordingly the decision of the ld. A.O is therefore correct and the addition should be sustained.

9. We have heard the rival contentions, analyzed the facts and circumstances and have perused the relevant materials on record. The ld. A.O has brought in the chargeability of sec. 9, clause (vi) read with Explanation 5, in particular Explanation 5, clause (c) and has held that sec. 9 which deals with income deemed to accrue or arise in India and as per clause (vi) the payment made to a nonresident entity has to be subjected to TDS whether or not such non-resident has any P.E. in India or not. The ld. A.O was of the opinion that the server charge which is paid by the assessee is also a type of service where right to use the server is inherent and thus falls in the definition of royalty. There is no requirement of having P.E in India for applicability of TDS and since the assessee has received services in India and the TDS has not been deducted u/s 195 of the Act therefore, such payment was inadmissible u/s 40(a) of the Act. In the order of the ld. A.O he mentions that the use of server by the assessee is inherent in the business of the assessee and therefore, the server charge is also a type of service and thus it is nothing but royalty. In holding so, the ld. A.O should have also looked into the provisions of DTAA between India and Netherland and should have specifically brought out the business functions of the assessee and analyzed such business functions vis-à-vis the applicability of the said DTAA and the Income-tax Act, while adjudicating the issue. In this case, the ld. A.O holds the payment made by the assessee as royalty and fees for technical services and makes it chargeable to tax as per sec. 9 clause (vi) read with Explanation 5 clause (c) of the Act but does not discusses the provisions of the DTAA and its applicability to the business of the assessee. If the genesis of assessee"s business functions provides for applicability of DTAA then it shall over-ride the provisions of the Act. We further observe that the ld. CIT(A) in his findings is absolutely silent about the applicability of provisions of DTAA between India

and Netherland to the transaction of the assessee. The ld. CIT(A) simply upheld the findings of the ld. A.O on the basis of the provisions of the Act but whether the assessee"s transaction is covered under the definition of

royalty or fees for technical services as per Article 12 of the relevant DTAA, the ld. CIT(A) has not given any finding in this regard. The order of ld. CIT(A) suffers from lack of verification of facts and applicability of legal provisions in the subject matter of the case. Neither the ld. A.O nor the ld. CIT(A) has given a categorical finding regarding the nature of business of the assessee and what facts, verification are conducted in determining the transaction of the assessee, nothing has been brought on record. The ld. A.O has stated in his order that there is inherent use of the server and therefore, the service charge paid will amount to royalty but what is this inherent use and how the business of the assessee is working so far as the use of server is concerned. these detailed examination and results has not been brought out in the order. Most important whether the provision of the relevant DTAA regarding royalty and fees for technical services are applicable in the case of the assessee or not has to be re-examined. Even the ld. .D.R has submitted specifying the agreement of Softlayer Technologies Inc. and therein it has been clearly spelt out regarding use of trademark that such trademark ownership is exclusively with Softlayer Technologies Inc. and that the assessee has right only to use such trademark. If it is the right to use trademark, then that is covered within the definition of royalty as per Article 12 of the relevant DTAA. Therefore, this agreement (supra) also has to be looked into along with the provisions of DTAA. The ld. A.O shall come out with a speaking order on all these aspects after due verification. In view thereof, we set aside the order of the ld. CIT(A) and remand the matter to the file of the ld. A.O for re-adjudication as per law after complying with principles of natural justice. The grounds are allowed for statistical purposes.

10. In the result, **appeal of the assessee is allowed for statistical purposes**.

Order pronounced in the open court on this 2nd day of March 2023.

Sd/-	sd/-
(G.D. PADMAHSHALI)	**(PARTHA SARATHI CHAUDHURY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Pune; Dated, the 2nd day of March 2023. Ankam

Copy of the Order forwarded to :

1. The Appellant.
2. The Respondent.
3. The CIT(A)-1, pune
4. The Pr. CIT- 1 Pune
5. D.R.ITAT „C" Bench
5. Guard File

BY ORDER,

/// TRUE COPY ///

Sr. Private Secretary
ITAT, Pune.

		Date	
1	Draft dictated on	28-02-2023	Sr.PS
2	Draft placed before author	01-03-2023	Sr.PS
3	Draft proposed and placed before the second Member		JM/AM
4	Draft discussed/approved by second Member		AM/JM
5	Approved draft comes to the Sr. PS/PS		Sr.PS/PS
6	Kept for pronouncement on	02-03-2023	Sr.PS/PS
7	Date of uploading of order	02-03-2023	Sr.PS/PS
8	File sent to Bench Clerk	*02-03-2023*	Sr.PS/PS
9	Date on which the file goes to the Head Clerk		
10	Date on which file goes to the A.R		
11	Date of dispatch of order		