IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'I' BENCH, MUMBAI

[Coram: Pramod Kumar (Vice President),
and Saktijit Dey (Judicial Member)]

ITA No. 5249/Mum/2019
Assessment year: 2011-12

Racksapce US, Inc. **……..……Appellant**
C/o Deloitte Haskins & Cells LLP,
Indiabulls Finance Centre, Tower-3,
27th to 32th Floor, Senapati Bapat Marg,
Elphinstone Road (W)Mumbai 400 013,
[PAN: AAECR7201H]

Vs.

Deputy Commissioner of Income Tax
International Taxation 4(1)(1), Mumbai **……Respondent**

Appearances by
Nitesh Joshi *for the appellant*
Sanjay Singh *for the respondent*

Date of concluding the hearing : January 7, 2021
Date of pronouncement : January 29, 2021

O R D E R

Per Pramod Kumar, VP:

1. This appeal, filed by the assessee, calls into question the correctness of the order dated 24th June 2019 passed by the Assessing Officer under section 143(3) r.w.s. 147 of the Income Tax Act, 1961, for the assessment year 2011-12.

2. Grievances raised by the appellant are as follows:

Ground no. 1: Income from cloud hosting services is erroneously held as royalty within the meaning of explanation 2 to section 9(l)(vi) of the Income Tax Act, 1961 (the Act) as well as Article 12(3)(b) of the India - US tax treaty

1.1. On the facts and circumstances of the case and in law, the learned AO, pursuant to the directions of the Hon'ble DRP erred in holding that cloud hosting system is combination of hardware, software and networking elements that constitutes industrial / commercial / scientific equipment and the income of

INR 19,93,10,915 earned by the Appellant from cloud hosting services is for use of or right to use industrial / commercial / scientific equipment which would constitute royalty under section 9(l)(vi) of the Act.

1.2. On the facts and circumstances of the case and in law, the learned AO, pursuant to the directions of the Hon'ble DRP, erred in holding that the income earned by the Appellant is for use of or right to use industrial / commercial / scientific equipment and constitutes royalty under Article 12(3)(b) of the India - US tax treaty.

1.3. On the facts and circumstances of the case and in law, the learned AO, pursuant to the direction of the Hon'ble DRP, erred in holding that the definition of royalty under the Act (as retrospectively amended by Finance Act, 2012) can be applied even for the purposes of determination of royalty income under Article 12 of the India - US tax treaty in the absence of any corresponding amendment in the India - US tax treaty.

1.4. On the facts and circumstances of the case and in law, the learned AO, pursuant to the directions of the Hon'ble DRP, erred in holding that the Aopellant is providing license to clients for use of third party software and the income earned therefrom is also royalty under the Act as well as the India - US tax treaty.

1.5. Without prejudice to aforesaid, the learned AO erred in holding that the amendment to the definition of 'royalty' under Section 9(l)(vi) of the Act made by Finance Act, 2012 is retrospective in nature and the same has only clarified the meaning of the term 'royalty' under the Act.

Ground no. 2: Income from cloud hosting services is also erroneously held as fees for technical services within the meaning of section 9(1)(vii) of the Act as well as fees for included services under Article 12(4)(a) of the India - US tax treaty

2.1 On the facts and circumstances of the case, the learned AO further erred in holding that the income from cloud hosting services is in the nature of Fees for Technical Services within the meaning of explanation (2) to clause (vii) of subsection (1) of section 9 of the Act.

2.2 On the facts and circumstances of the case, the learned AO erred in holding that the income from cloud hosting services also qualifies as fees for included services within the meaning of Article 12(4)(a) of the India-US tax treaty.

Ground no. 3: Erroneous levy of interest under section 234A of the Act

3.1 On the facts and circumstances of the case and in law, the learned AO erred in levying interest of INR 53,65,910 under section 234A of the Act.

Ground no. 4: Erroneous levy of interest under section 234B of (he Act

4.1 On the facts and circumstances of the case and in law, the learned AO erred in levying interest of INR 68,10,606 under section 234B of the Act.

Ground no. & Erroneous levy of interest under section 234Cof the Act

5.1 On the facts and circumstances of the case and in law, the learned AO erred in levying interest of INR 3,47,407 under section 234C of the Act.

3. As learned representatives fairly agree, the issues raised in this appeal are covered in favour of the assessee, by the decision of coordinate bench dated 28th November 2019, in assessee own cases for the assessment years 2010-11 & 2015-16, wherein the coordinate bench has *inter alia* observed as follows:-

3. The brief facts of the case are that the assessee did not file any return of income for the A.Y.2010-11 and certain transactions were seen in the NMS data base available in 1- Taxnet System based on which the AO recorded reason to believe in accordance with provisions of Section 147 of the I.T. Act that the income has escaped taxation. After obtaining the approval from CIT(IT)-4 and recording the reasons for reopening of the assessment dated 31.03.2017, notice u/s 148 of the Act was issued and served upon the assessee. Thereafter, the notices u/s 143(2) & 142(1) of the Act were issued and served upon the assessee. The assessee is a company incorporated in and a tax resident of USA. During the year under consideration, the assessee earned income from cloud services including cloud hosting and other supporting and ancillary services provided to Indian Customers. The assessee filed the return of income and the notes stating therein that the cloud hosting services was not taxable as 'royalties' under Article 12 of the India-US tax treaty as the customers do not operate the equipment or have physical access to or control over the equipment used by the assessee to provide cloud support services and do not make available technical knowledge, experience, skill, know-how etc., to its Indian Customers and the cloud support services are not in the nature of managerial, technical or consultancy services and consequently same do not constitute fees for included services within the meaning of Article 12 of the India-USA Double Tax Avoidance Agreement (DTAA). The assessee claimed that revenues earned on account of cloud hosting services constitute business profits and since it did not have Permanent Establishment (PE) in India under Article 5 of the DTAA, the same would not be subject to tax in India under the provisions of Article 7(1) of the DTAA. There was a mismatch of receipts as per 26AS and as per party-wise receipts furnished by assessee, therefore, the notice was also issued. After the reply of the assessee and in accordance in the direction of the DRP, the receipt in sum of Rs.17,12,52,670/- was considered as 'Royalty' and held to be taxable @ 10% as per IndiaUSA DTAA prescribed taxation rate. Feeling aggrieved, the assessee filed the present appeal before us.

ISSUE Nos.1.1 to 1.5

At the very outset, the Ld. Representative of the assessee has argued that the issue has squarely covered by the decision of the Hon'ble ITAT in the assessee's own case for the A.Y. 2012-13 in ITA. No.1634/M/2016, ITA. No.1075/M/2017 for the A.Y.2013-14

& ITA. No.3507/M/2017 for the A.Y.2014-15 dated 29.05.2019, therefore, in the said circumstances, the issues are liable to be decided in favour of the assessee in accordance with law. However, on the other hand, the Ld. Representative of the Department has refuted the said contention. Before going further, we deem it necessary to advert the finding of the Hon'ble ITAT in the assessee's own case(supra) on record: -

> *"10. We have heard the rival contentions and gone through the facts and circumstances of the case. We noted that as per the provisions of section 9(1)(vi) of the Act royalty is taxable in India inter alia if the payer an Indian resident, except where the royalty is payable in respect of a right, property, information or service used for the payer's business outside India or for earning income outside India. Explanation 2 to section 9(1)(vi) of the Act dealing with the definition of royalty inter alia includes payment for use or right to use an industrial, commercial or scientific equipment. Considering the fact that Rackspace USA customers only avail hosting services and do not use, possess or control the equipment used for providing hosting services (which are owned and controlled by Rackspace US), the payment for hosting services made by Indian customers to Rackspace USA does not fall within the ambit of the said definition. Finance Act, 2012 inserted an amendment in the definition of royalty whereby the definition of royalty was expanded by inserting Explanation 4, 5 and 6 to section 9(1)(vi) of the Act (with retrospective effect from I June 1976). Explanation of section 9(I)(vi) of the Act reads as under:*
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> > *"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- (a) the possession or control of such right, property or information is with the payer; (b) such right, property or information is used directly by the payer; (c) the location of such right, property or information is in India."*
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> > *11. The above amendment clarified that any payments made for the 'use of equipment would be classified as 'royalties' irrespective of the possession or control of the equipment with the payer or use by the payer or the location of the equipment being in India. But, under the provisions of section 90(2) of the Act, an assesse can opt be governed by the provisions of the tax treaty to the extent they are more beneficial than the provisions of the Act. We noted the fact that Rackspacc USA is tax resident of USA and therefore, is entitled to claim the beneficial provisions of India-USA tax Treaty with respect to the taxability of its income earned from Indian payers. The Tax Residency Certificate along with Form 10F has been submitted by the assessee vide letter dated 29.01.2015 and 13.02.2015 for the years 2011 and 2012.*
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> > *12. We have gone through the provisions of Article 12(3) of the IndiaUSA Tax Treaty, wherein the term royalties' are defined to mean:*

(a) 'payments of any kind received as a consideration for the list of or the right to Use', any copyright of literary, artistic or scientific work including cinematograph or work on ten, tape or other means of reproduction for use in connection it radio or television broadcasting, any patent, trade mark, design or model, plan secret formula or process, or for information ('concerning industrial, commercial or scientific experience including gains derived from the alienation of any such rig/it or property which are Contingent on the productivity, use, or disposition thereof; and

(b) Payments of any kind received as consideration for the use, or right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8" (Emphasis supplied).

13. As may be observed, the definition of royalty under Article 12(3) of the India-USA Tax Treaty in respect of payment for use or right to use equipment is in pari-materia with the pre-amendment definition of royalties in the Act. The said definition of "royalties" is exhaustive and not inclusive and therefore, it has to be given the meaning as contained in the Article itself and no other meaning should be looked upon.

14. From the above, it is clear that the services provided by Rackspace USA to that Indian customers are not covered by the above definition of 'royalties' provided in the India USA Tax Treaty since Rackspace USA is providing hosting services to the Indian customers and does not give any equipment or control over the equipment. The term 'use' or 'right to use' for the purpose of the tax treaty entails that the prayer has a possession/ control over the property and/ or the said property is at its disposal. There is no privilege or right granted to the Indian customers over the servers and other equipment used to provide cloud hosting services. The equipments are not used by the customers and the same are used by Rackspace USA to provide service to the customers. The services provided by the Rackspace USA are in the nature of cloud hosting, data warehousing services etc. which are standard services provided to customers. There is no agreement to hire or lease out any equipment but only a service level agreement.

15. In the light of the above, we are of the view that the amendments in the domestic tax law cannot be read into the tax treaty as there is no change in the definition of 'royalties' under the India-USA Tax Treaty. Therefore, the retrospective amendment in the royalty definition under the Act does not impact the definition of 'royalties' in the India-USA Tax Treaty. Further, the identical issue has been decided by the co-ordinate Bench of this Tribunal in the case of Americal Chemical Society vs. DCIT in ITA No. 6811/Mum/2017 for the AY 2014-15 vide order dated 30.04.2019, wherein identical issue was decided by Para 17 to 19 as under: -

"17. We have heard the rival submissions and perused the relevant material on record including the order of the lower authorities on the issue in dispute. We find that issue with respect to the PUBS division coincides with the issues on the CAS fee. The journal provided by the PUBS division do not provide any information arising from assessee's previous experience. The assessee's experience lies in the creation of / maintaining such information online. By granting access to the journals, the assessee neither shares its experiences, techniques or methodology employed in evolving databases with the users, nor imparts any information relating to them. As is clearly evident from the sample agreements, all that the customers get is the right to search, view and display the articles (whether online or by taking a print) and reproducing or exploiting the same in any manner other than for personal use is strictly prohibited. Further, the customers do not get any rights to the journal or articles therein.

They can only view the article in the journal that they have subscribed to and cannot amend or replicate or reproduce the journal. Thus, the customers are only able to access journal/articles for personal use of the information. No 'use or right to use' in any copyright or any other intellectual property of any kind is provided by the assessee to its customers. Furthermore, the information resides on servers outside India, to which the customers have no right or access, nor do they possess control or dominion over the servers in any way.

Therefore, the question of such payments qualifying as consideration for use or right to use any equipment, whether industrial, commercial or scientific, does not arise.

18. To put a comparison, if someone purchases a book, then the consideration paid is not for the use of the copyright in the book/ article. The purchaser of a book does not acquire the right to make multiple copies for re-sale or to make derivative works of the book, i.e., the purchaser of a book does not obtain the copyright in the book. Similarly, the purchaser of the assessee's journals, articles or database access does not have the right to make copies for re-sale and does not have the right to make derivative works. In short, the purchaser has not acquired the copyright of the article or of the database. What the buyer gets is a copyrighted product, and accordingly the consideration paid is not royalty, but for purchase of a product. In the instant case too, what is acquired by the customer is a copyrighted article, copyrights of which continue to lie with assessee for all purposes. lt is a well settled law that copyrighted article is different from a copyright, and that consideration for the former, i.e. a copyrighted article does not qualify as royalties. 19. Thus, the principles noted by us in the earlier part of this order in the context of the income earned by way of CAS fee are squarely applicable to the subscription revenue received from customers of PUBS division for sale of journal also, and accordingly PUBS fee also does not qualify

as 'Royalty' in terms of section 9(1)(vi) of the Act as well as Article 12(3) of the India-USA DTAA."

16. From the above facts and circumstances, we are of the view that the agreement between the assessee and its customer is for providing hosting and other ancillary services to the customer and not for the use of / leasing of any equipment. The Data Centre and the Infrastructure therein is used to provide these services belong to the assessee. The customers do not have physical control or possession over the servers and right to operate and manage this infrastructure / servers vest solely with the assessee. The agreements entered into the service level agreements. The agreement is to provide hosting services simpliciter and is not for the purpose of giving the underlying equipment on higher or lease. The customer is not even aware of the specific location of the server in the Data Centre where the customer application, web mail, websites etc. In view of these facts, we are of the view that income from cloud hosting services has erroneously held as royalty within the meaning of explanation (2) to section 9(1)(vi) of the Act as well as Article 12(3)(b) of the Indo-USA DTAA by the AO and DRP. Even otherwise, there is no PE of the assessee in India and hence, no income can be taxed in India in term of Indo-US DTAA. We reverse the orders of the lower authorities and allow this issue of assessee's appeal."

5. On appraisal of the above mentioned finding, we find that the agreement between the assessee and its customers is for providing hosting and other ancillary services to the customers and not for the use of leasing any equipment. The data centre and the infrastructure therein used to provide these serves belongs to the assessee. The customers are not having physical control or possession over the servers and right to operate and manage this infrastructure/servers vest solely with the assessee. The agreement is to provide hosting services simpliciter and is not for the purpose of giving the underlying equipment on hire or lease. The customer was not knowing any location of the server in data centre, web mail, websites etc. Accordingly, it cannot be said as royalty within the meaning of Explanation (2) to Section 9(1)(vi) of the Act as well as Article 12(3)(b) of the Indo-USA Data by the AO and DRP. Moreover, there is no PE of the assessee in India and hence, no income can be taxed in India in term of Indo-US DTAA. The facts are not distinguishable in this order also. Therefore, the finding above is quite applicable to the facts of the present case. Accordingly, we find that the issue is squarely covered by the decision of Hon'ble ITAT in the assessee's own case(supra), hence, we decide these issues in favour of the assessee against the revenue.

ITA. No. 2

6. Issue no.2 is also in connection with the order of the DRP and AO holding the income from cloud hosting services as fee for technical services within the meaning of Section 9(1)(vii) of the Act as well as fee for included services under Article 12(4)(a) of the IndoUS DTAA. The Ld. Representative of the assessee has also argued that this issue is also covered by the decision of the Hon'ble ITAT in the assessee's own case for the A.Y. 2012-13 in ITA. No.1634/M/2016, ITA.

No.1075/M/2017 for the A.Y.2013-14 & ITA. No.3507/M/2017 for the A.Y.2014-15 dated 29.05.2019, therefore, in the said circumstances, the issue is liable to be decided in favour of the assessee in accordance with law. However, on the other hand, the Ld. Representative of the Department has refuted the said contention. Before going further, we deem it necessary to advert the finding of the Hon'ble ITAT in the assessee's own case(supra) on record:-

> *"17. The second common issue in these appeals of assessee is as regards to the order of DRP and AO holding the income from cloud hosting services as fee for technical services within the meaning of section 9(1)(vii) of the Act as well as fee for included services under Article 12(4)(a) of the Indo-US DTAA. For this assessee has raised the following ground No. 2: -*
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> > *"Ground No. 2: Income from cloud hosting services is also erroneously held as fees for technical services within the meaning of section 9(1)(vii) of the Act as well as fees for included services under Article 12(4)(a) of the India-US tax treaty 2.1 On the facts and circumstances of the case, the learned AO further cmxl in holding that the income from cloud hosting services is in the nature of Fees for Technical Services within the meaning of explanation (2) to clause (vii) of subsection (1) of section 9 of the Act. 2.2 On the facts and circumstances of the case, the learned AO erred in holding that the income from cloud hosting services also qualities as fees for included services within the meaning of Ankle 12(4)(a) of the India-US tax treaty."*
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> *18. As we have already decided the above issue that income from could hosting services is erroneously held as royalty, on the same reasoning, the income from cloud hosting services cannot be taxed as fee for technical services and this issue has been decided by the DRP against Revenue by holding the same as infructuous. For this Revenue is not in appeal."*

7. The facts are not distinguishable at this stage. The Hon'ble ITAT has treated this issue as in fructuous on the basis of the finding given while deciding the issue no. 1 in which the income was not treated as royalty within the meaning of Explanation-2 to Section 9(1)(vi) of the Act as well as Article 12(3)(b) of the Indo-USA DTAA tax treaty. Accordingly, by following the decision of co-ordinate bench, the present issue is decided in favour of the assessee against the revenue. ITA. No. 3

> *8. Under this issue the assessee claimed that the assessee was not entitled to pay the interest u/s 234B of the Act. At the very outset, the Ld. Representative of the assessee has argued that the issue has also been covered in favour of the assessee in view of the decision of the Hon'ble ITAT in the assessee's own case(supra), therefore, the assessee was not liable to pay the interest u/s 234B of the Act. However, on the other hand, the Ld. Representative of the Department has refuted the said contention. Before going further, we deem it necessary to advert the finding of the Hon'ble ITAT in the assessee's own case(supra) on record:-*

"20. At the outset, the learned Counsel for the assessee stated that the issue is squarely covered by the decision of Hon'ble Bombay High court in the case of DIT(IT) vs. Ngc Network Asia LLC [2009] 313 ITR 187 (Bombay), wherein it is held that when a duty is cast on payer to deduct and pay the tax at source, on payer's failure to do so interest under section 234B of the Act cannot be imposed on payee assessee. Hon'ble High Court held as under: -

> *"5. Under the provisions of the present Act, the issue had come for consideration in the case of CIT v. Sedco Forex International Drilling Co. Ltd. [2004] 186 CTR (Uttaranchal) 144 : [2003] 264 ITR 320 (Uttaranchal). One of the questions was, as to whether interest could be levied on the assessee under s. 234B of the Act in respect of tax which was not liable to be deducted at source. A learned Bench of the Uttaranchal High Court, after considering the provisions, held as under:*

"Secondly, although s. 191 of the Act is not overridden by ss. 192, 208 and 209(1)(a)/(d) of the Act, the scheme of ss. 208 and 209 of the Act indicates that in order to compute advance tax the assessee has to, inter alia, estimate his current income and calculate the tax on such income by applying the rates in force. That under s. 209(1)(d) the incometax calculated is to be reduced by the amount of tax which would be deductible at source or collectible at source, which in this case has not been done by the employer company according to the law prevailing for which the assessee cannot be faulted." 6. Relying on the judgment in Sedco Forex International Drilling Co. Ltd. (supra), a learned Bench of this Court was pleased to pass an order dt. 16th July, 2008 in IT Appeal (L) No. 1796 of 2007 in the case of the Director of IT (International Taxation) v. Morgan Guarantee International Finance Corporation, by applying the ratio of that judgment. 7. Our attention is also invited to the judgment of the Madras High Court in the case of CIT v. Madras Fertilisers Ltd. [1984] 149 ITR 703 (Mad), where the Madras High Court took the view that the amount of tax deductible at source is to be taken into consideration to determine the liability to pay the interest under s. 215. In that case, the assessee had not paid advance tax on interest income. The payer of interest had not deducted the tax. The learned Bench of the Madras High Court was of the view that levy of interest under s. 215 on assessee was not justified. 8. We are in respectful agreement with the view taken In the case of CIT v. Sedco Forex International Drilling Co. Ltd. (supra), by the Uttaranchal High Court. We are clearly of the opinion that when a duty is cast on the payer to pay the tax at source, on failure, no interest can be imposed on the payee assessee."

21. In view of the above, we direct the AO not to charge interest under section 234B of the Act in the given facts and circumstances of the case."

9. By following the decision of the ITAT in the Assesses own case, we are of the view that the assessee was not under obligation to pay the interest. In the said decision ITAT has decided the matter in view of the decision of the Hon'ble Bombay High

Court in the case of DIT(IT) Vs. Ngc. Network Asia LLC (2009) 313 ITR 187 (Bom). Since the issue is squarely covered by the decision of Hon'ble Bombay High Court, therefore present issue is decided in favour of the assessee against the revenue.

ITA. NO.4920/M/2018

10. The facts of the present case are quite similar to the fact of the case as narrated above while deciding the ITA. No.6195/M/2018, therefore, there is no need to repeat the same. However, the figure is different. The matter of controversy is also the same. The finding given above while deciding the appeal of the assessee bearing ITA. No.6195/M/2018 is quite applicable to the facts of the present case as mutatis mutandis. Accordingly the present appeal is hereby allowed.

11. In the result, the appeal filed by the assessee is hereby ordered to be allowed.

4. Even though learned representative have fairly agreed that the issues raised in this appeal are squarely covered by the aforesaid decision, the learned Departmental Representative has nevertheless relied upon the stand of the Assessing Officer. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the plea of the assessee and hold that the observations above will apply *mutatis mutandis* here as well. The assessee gets the relief accordingly.

5. In the result, the appeal is allowed. Pronounced in the open court today on the 29th day of January, 2021.

Sd/-
Saktijit Dey
(Judicial Member)

Sd/-
Pramod Kumar
(Vice President)

Mumbai, dated the 29th day of January, 2021

N.V, Sr.PS

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *CIT* *(4)* *CIT(A)*
(5) *DR* *(6)* *Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai