आयकर अपीलीय अधिकरण "I" न्यायपीठ मुंबई में।

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

श्री महावीर सिंह, न्यायिक सदस्य एवं श्री राजेश कुमार लेखा सदस्य के समक्ष ।

BEFORE SRI MAHAVIR SINGH, JM AND SRI RAJESH KUMAR, AM

आयकर अपील सं./ ITA No. 1634/Mum/2016

(निर्धारण वर्ष / Assessment Year 2012-13)

आयकर अपील सं./ ITA No. 1075/Mum/2017

(निर्धारण वर्ष / Assessment Year 2013-14)

आयकर अपील सं./ ITA No. 3507/Mum/2017

(निर्धारण वर्ष / Assessment Year 2014-15)

Rackspace, US Inc. 1 Fanatical Place, Windcrest, Texas, USA	Vs.	The Dy. Commissioner of Income Tax, (international Taxation) 4(1)(1), Room No. 120, 1st Floor, Scindia House, Ballard Estate, N.M. Road, Mumbai-400 038
(अपीलार्थी / Appellant)	..	**(प्रत्यर्थी / Respondent)**
स्थायी लेखा सं./**PAN No. AAECR7201H**		

अपीलार्थी की ओर से / **Appellant by**	:	S/Shri PJ Pardiwala, Nitesh Joshi & Ms. Nyrica T, ARs'
प्रत्यर्थी की ओर से **/ Respondent by**	:	S/Shri Kumar Sanjay, CIT DR & Chaudhary Arun Kumar, DR

सुनवाई की तारीख **/ Date of hearing:**	01.03.2019
घोषणा की तारीख **/ Date of pronouncement :**	29.05.2019

आदेश / O R D E R

महावीर सिंह, न्यायिक सदस्य/
PER MAHAVIR SINGH, JM:

These three appeals by the assessee are arising out of the different orders of Dispute Resolution Panel-2, Mumbai [in short 'DRP'], in objection No. 279, 007, 037 vide direction dated 28.12.2015, 21.02.2017, 15.09.2016. The Assessments were framed by the Dy. Commissioner of Income Tax (Int. Tax)-Circle 4(1)(1), Mumbai (in short 'DCIT/AO') for the assessment years 2012-13, 2013-14 & 2014-15 vide order dated 15.01.2016, 07.11.2016, 08.12.2016 under section 144C(5) read with section 143(3) of the Income Tax Act, 1961(hereinafter 'the Act).

2. The first common issue in these appeals of assessee is against the order of DRP holding income from cloud hosting services as royalty within the meaning of explanation 2 to section 9(1)(vi) of the Act. As the issue is exactly identical in all the assessment years i.e. AY 2012-13 to 2014-15, we take up the issue from AY 2012-13 and will decide the issue for all the appeals. For this assessee has raised the following grounds:-

> *"Ground no. I: Income from cloud hosting services is erroneously held as royalty within the meaning of explanation 2 to section 9(I)(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 Deputy Commissioner of Income- tax (International tax) - 4(1)(1) ("AO")*

pursuant to the directions of the Hon'ble Dispute Resolution Panel (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 Rs.29,49,01.258/- 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(1)(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 I 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 / 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 assessee 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."

3. Briefly stated facts are that the assessee has filed its return of income for the AY 2012-13 disclosing the total income of ₹ 29,49,01,258/- earned from provisions of public cloud hosting and dedicated/ managed hosting of services to Indian customers. The assessee claimed that this income is in the nature of business income and not taxable in India in the absence of Permanent Establishment of the assessee in India i.e. (PE). Accordingly, the assessee claimed refund of ₹ 1,09,50,295/- on account of TDS etc. The AO framed the draft assessment order dated 30.03.2015 under section 144C(1) r.w.s 143(3) of the Act by holding that the receipt received by the assessee in respect to royalty and fee for technical services on account of public cloud hosting and dedicated/ managed hosting of services to Indian customers are taxable in India. The assessee carried the matter before DRP and raised objections. But the DRP vide order directions dated 28.12.2015 under section 144C(5) directed the AO to treat the income from cloud hosting services as royalty

within the meaning of section 9(1)(vi) of the Act as well as under Article 12(3)(b) of Indo-US DTAA, by observing as under: -

> *"3.4 Discussion and directions of DRP:*
>
> *3.4.1 We have perused the submissions made by appellant as above. The case of the appellant primarily hinges upon the assumption that since the agreement is for service and not for leasing or hiring of equipment and since the customer has no physical control/ possession over the equipment, no right to use of an industrial, commercial or scientific equipment has been granted by the assessee and that the assessee and that the services rendered by the appellant are in the nature of standard facilities extended to the payers. The AO has discussed in great details the nature of services rendered by appellant to its customers in Para 5.5. of the assessment order which clearly suggest that the services provided by appellant are under contractual agreements with certain rights and restrictions for both parties. The appellant provides rack space in its data centers situated outside India which host the customer's data/ applications. The data center house highly confidential and privileged data of various customers and hence needs robust foolproof security systems in place. The appellant is as availability of live assistance twenty-four hours*

per day, seven days per week, year round by Rackspace employees with training and experience relative to the Services and any additional level of assistance offered by Rackspace for the specific Services ordered by clients. Para 19 of the Rackspace Cloud Terms of service (as rendered by AO in assessment order) deal with software which suggests that the appellant through its hosting services, is also providing use of third party software to clients. Para 30 to 38 of the Rackspace Cloud Terms of service (as referred by AO in assessment order provides for the additional terms for certain services which suggest that part from providing server and other equipments, various other services are also provided by the appellant, which are highly technical and specialized services and it is the responsibility of the appellant to provide the same. Moreover, these services are ancillary and subsidiary to the enjoyment of server and other equipments for which the payments are being received by the appellant. Thus a data center is a specialized facility which comprises inter alia, the server on which data/ applications are actually hosted and network, hardware equipments winch facilitate the connectivity of the server with the outside world and other software to process the data on the server. Thus

the data center comprising of hardware, operating software and network will be in nature of an industrial/commercial/ scientific equipment and customer uses the Cloud infrastructure and also has access and control over such infrastructure for limited purpose of its use to the extent authorized under the agreement, as the data stored on server at all times remains the exclusive control and ownership of the customer only. Hence by entering the agreements for using the data center and availing other specialized services through such data centers, the customer gels the right to use the industrial/commercial/ scientific equipment and the payment for such use will be royalty u/s 9(1)(vi) of the Act By use of the property under agreement, the customer gets economic and possessory interest in such property to such extent and hence it would fall under meaning of Royalty even without the amendment as held by Madras High court in case of Verizon Communication Singapore Pte 361 ITR 575 (Mad). The High court further observed in the context of DTAA with Singapore that the definition of 'royalty' under tax treaty and the Act are in pan - materia. The provisions of Royalty under DTAA with USA are similarly worded as that of Singapore and hence the observations of

High court shall equally apply to present case also.

3.4.2 Even otherwise, the Finance Act 2012 has clarified that the payment for use of right, property or information would be considered as royalty irrespective of whether the possession and control of the right, property or information is with the payer, whether it is actually used by the control of the right, property or information is with the payer, whether it is actually used by the

Prayer or whether the location of such right, property or information is in India. This amendment further strengthens the contention that such amount is taxable as Royalty under Indian domestic tax law even in situations where the customer arguably does not possess or control the right, property an information. The Madras high court in Verizon Communication Singapore Pte (supra) also observed that after the amendment was introduced in Section 9(1)(vi) of the Act in the year 2012, irrespective of possession, control with the payer or use by the payer or the location in India, the consideration would nevertheless be treated as royalty'. The decisions relied by the appellant in case of People Interactive (I) P Ltd delivered on 29/2/2012 is therefore distinguishable as it has based its decision mainly on the arguments that

no right to use was granted by appellant as the possession and control of the right, property or information or the location of such right, property or information was not with the pave: in India and that the services were not rendered in India. The amendment u/s 9(1)(vi) w.r.e.f. by Finance Act 2012 was not at all considered by the ITAT while rendering the decision in case of People Interactive (I) P Ltd. (supra). Hence, the same will have no binding precedent value. For the same reasons all other decisions rendered on the basis of possession, control or location of the right, property or information, prior to retrospective amendment shall not be applicable now. Hon. Madras High court in Verizon Communication Singapore Pte (supra) after considering the decision of Delhi High court in Asia satellite Telecommunications Co. Ltd 197 Taxmann 263, also observed that in light of the Clarificatory amendments inserted in Section 9 of the Act by the Finance Act, 2012 the decision of the Delhi High court in the case of Asia Satellite is distinguishable and has no relevance to the case on hand. On the other hand, the ratio of decision of ITAT Mumbai in case of Reuters transactions services Ltd. (supra) Viacom 18 Media Pvt. Ltd. (supra), will squarely apply to the facts of the assessee's case as in these decisions post amendment the

possession, control or location of the right, property or information have not been considered to be relevant for determination of royalty under the Act. The decision in Reuters transactions services Ltd(supra) was also rendered in context with DTAA with USA. it is also undisputed fact that the appellant also provides the software supplied by third parties wider the license agreements and therefore payment for use of such software will also be in nature of Royalty under the Act in view of Mumbai ITAT decision in case of Reliance Infocom Ltd 159 TTJ 589 (mum).

3.4.3 The other major contention of appellant is that the amendment in the Act cannot he read into the treaty to determine the nature of payment as Royalty under the DTAA. We have considered the decisions relied by appellant in support of this contention including the decision of jurisdictional high court in case of Siemens Aktiengesellschaft 310 ITR 320(3om). It is noted that the retrospective amendment in explanation 5 has only clarified the meaning of Royalty. It has not a: all expanded the scope of royalty. The clarification was made to remove the conflicting views on effect of location/possession/control/delivery/use of the royalty rights etc. by the user in India without

bringing any fresh item to be taxable s royalty. It is for this reason the amendment is retrospective and starts with clause "for removal of doubt it is clarified". Hence by amendment it is not that the definition of Royalty is being enlarged. It is also not a case where items not taxable under DTAA are being now taxed under the Act. Definition of Royalty in DTAA and Act are Pari material as recently held by Madras High court also in case of Poompuhar Shipping 360 ITR 257 and Verizon Communication Singapore Pte 361 ITR 474 (Mad). Art 3(2) of DTAA stipulates that any term not defined shall have meaning as assigned under Act. As per section 90(2), provisions of DTAA shall apply if they are more beneficial in case there is conflict between DTAA and Act. There can be no dispute that for tax liability of any item beneficial provision has to be given preference. But there it is not a case of conflict of brining a new item of taxation or creating a fresh tax liability under Act in respect of Royalty payments which is otherwise not taxable under DTAA. Rather it is a case of Clarificatory only wherein the expression 'right to use', which is used both under the Act and DTAA in the context of Royalty, has been explained to be fulfilled whether or not, the location/possession/control/delivery/use of the rights, property or equipment, etc. by the user

was in India. Thus in absence of any clarification in DTAA in respect of location /possession /control /delivery /use of the royalty rights etc. by the user in India for ascertaining the meaning of Royalty, the conditions as per explanation 5 has to be read into for purposes of DTAA also in view of article 3(2) provided within the DTAA itself.

3.4.4 The decision in case of Siemens Aktiengesellschft (supra) very heavily relied by appellant, which has been subsequently followed all other subsequent decisions relied by the appellant in its submissions as distinguishable. The controversy in Siemens (supra) was for the AY 79-80 under DTAA with Germany. The DTAA with Federal republic of Germany as notified as per (3SR 1090 on 13/9/1960 was applicable for AY 79-80. It did not have any definition for the term Royalty nor was there any separate article to deal with Royalties other than those mentioned in Article 111(3). Article III was dealing with taxability of industrial and commercial profits (business income) only and to the extent it was attributable to PR The Chennai DTAA was thereafter amended by notification dated 26-8-1985 wherein Article VIIIA of DTAA was introduced which deals with royalties and the term Royalty

was also defined therein. Under the Act section 9(l)(vi) defining royalty was introduced w.e.f 1/4/1976. Thus for AY 79-90 the situation was that there was a definition of royalty tinder the Act w.e.f 1/4/76 but there was no definition of Royalty under the German DTAA. So any income, even if in the nature of Royalty, was taxable only as industrial or commercial profits (business income) only to the extent it was attributable to PE. Article III of the DTAA applicable at that time read as under:

Article III

(1) Subject to the provision of paragraph (3) below, tax shall not be levied in one of the territories on the industrial or commercial profits of an enterprise of the other territory unless profits are derived in the first mentioned territory through a permanent establishment of the said enterprise situated in the first mentioned territory. If profits are so derived, tax may be levied in the first mentioned territory on the profits attributable to the said permanent establishment.

(2) There shall be attributed to the permanent establishment of an enterprise of one of the territories situated in the other territory, the industrial or commercial profits which it might be

expected to derive in that other territory if ti were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is the permanent establishment. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination, or the ascertainment thereof presents exceptional difficulties, the profits attributable to the establishment may be estimated on a reasonable basis.

(3) For the purposes of this Agreement the term "Industrial or commercial profits: shall not include income in the form of rents, royalties, interest dividends, management charges, remuneration for labour or personal services or income from the operation of ships or aircraft but shall include rents or royalties in respect of cinematographic films.

3.4.5 The above provisions of DTAA suggest that (j) there was no provision to tax Royalty under DTAA by way of a separate provision other than Royalty in respect of Cinematographic film tinder article 111(3) and (ii) it was to be taxed as cinematographic or industrial profits only if it was attributable to presence of a PE in India. Thus it was very clear

that under the relevant DTAA no item of receipt in nature of Royalty could be included as commercial profits under Article 111(3) unless it related to the use of cinematographic films. The case of the revenue in that case was that since the amounts received by assessee was in nature of Royalty under the Act after amendment u/s 9(1)(vi) w.e.f 1.4.76 and that Article 111(3) of DTAA did provide for taxation of Royalty, the amount was taxable as Royalty, even if there was no PE. Though the amounts received by assessee were held to be Royalty under the Act but in absence of any taxability of royalty at all under the DTAA and moreover in absence of any provision in DTAA granting the taxation rights to source country on royalties, the court held that beneficial provisions of DTAA are to be given precedence in view of section 90(2) and that the meaning of Royalty under the Act could not be imported to Article 111(3) of DTAA, which dealt specifically with industrial and commercial profits only and specifically excluded the income from Royalties other than in respect of cinematographic films. The income could not be taxed as industrial or commercial profits also under article 111(1) as there was no PR Thus in this case as per the prevalent DTAA at that time, the only taxable income in the nature Royalty was from cinematographic films

and all other Royalty were specifically excluded from ambit of article Ill. At the same time there was no separate provision for taxing the Royalty of any nature under DTAA. It was in the back ground of these provisions of the IYFAA with Germany which existed at that time that the court held that definition of Royalty as per Act could not be imported to DTA.A. Hence the decision of High court in Siemens Aktiengesellschaft (supra) cannot be applied to the cast where the definition/taxing rights for royalty has been specifically provided under the applicable DTAA also. Based on above decisions of Siemens Akticngcscilschaft, the contention that unless the definition of Royalty is changed. the amendments brought by Finance Act 2012 have no implication was also also argued by assessee in case of Viacom 18 Media Pvt. Ltd(supra) wherein ITAT has upheld the above argument of the revenue in Para 7,10,12 of its order dated 28/03.2014 and subsequently in case of Reuters transactions services Ltd. (supra) in para 10 of its order dated 14/07/2014, which was also under the USA treaty.

3.4.6 In view of the above discussions, the order of the AO treating the amounts paid as

Royalty under the Act as well under the DTAA is upheld."

4. Further, the assessee raised objection with regard to the findings of the AO in regard to the receipt of cloud hosting services of technical services within the meaning of explanation (2) to clause (vii) of sub-section (1) of section 9 of the Act and Article 12(4)(a) of Indo-USA DTAA. But the DRP again affirmed the action of the AO by observing in para 4.3 as under: -

"4.3 Discussion and Direction of DRP

4.3.1 Since in earlier Para 4.24 we have already held that the payments are in nature of Royalty under 9(1)(vi) of the Act as well as under Article 12(3) of the DTAA, the question of taxing same receipts as Fee for included services under section 9(1)(vii) of the Act and under Article 12(4)(a) of the DTAA becomes in fructuous. Hence the same is not adjudicated."

5. But, the AO finally framed the final assessment order under section 144C(5) read with section 143(3) dated 15.01.2016 by holding that the income of the assessee is taxable in India, in view of the directions of the DRP, on account of the following :-

"the receipts of INR 29,49,01258/- from provisions of cloud hosting services are also in the nature of royalty within the meaning of section 9(1)(vi) of the Act as well as Article 12(3)(b) of the India-US tax treaty; and

Without prejudice to above, the receipts from provision of cloud hosting services are also in the nature of technical services/ fees for included services within the meaning of explanation (2) to clause (vii) of subsection (1) of section 9 of the Act and Article 12(4)(a) of the India US tax treaty;."

6. According to AO, the assessee is exigible to tax at the rate prescribed under section 115(1)(b) of the Act on payment of royalty as fee for technical services to non-resident increased by applicable surcharge and education cess. According to AO, the rates are not beneficial rates of taxation as provided in Article 2 of the Double Taxation Avoidance Agreement (DTAA) between India and USA. Accordingly, the AO assessed the assessee. Aggrieved, assessee came in appeal before Tribunal.

7. Before us, the learned Counsel for the assessee stated that the assessee is a company incorporated and a tax resident of USA. The assessee is managed cloud computing company and providing services to its customers on payment of monthly fees and usage based fee. Hostage services comprises of hosting for applications, web mail, websites, etc. The learned Counsel for the assessee stated that the activity note was filed before the AO and DRP. He stated that the assessee is carrying out two types of hosting services that are customer typical purchase. He referred from the note which is as under: -

"Public Cloud Hosting: Public Cloud customers sign up online and agree to standard terms and conditions but do not sign actual written

contracts. Public Cloud hosting is provided as a service over the Internet. The customer's applications are hosted by the cloud service provider.

The core infrastructure is shared by several organizations but each organization's data and application usage is segregated by permitting access to specific data applications only to authorized users. Public Cloud is typically billed based on usage (pay-as-you-go model) so the customer does not have a long term commitment. It is a month-to-month service with no actual commitment from the customer to use it in any volume for any length of time.

Dedicated/ Managed hosting: The services rendered under to Dedicated' Managed Hosting customers is largely similar to the services rendered under to Public Cloud customers. The identified core infrastructure is used only for one customer wherein the customer would have remote access to the servers through the internet, but no access to the firewalls, load balances and network devices which are critical for the assessee to provide services to its customers.

For Dedicated Hosting, the customer signs a contract which typically has a duration of 12-36

months. It may be noted that a new contract is not signed every year. In addition, when a contract term ends, the customer can continue their dedicated service on a month-to-month basis without signing a new contract. The same terms and fees will apply unless a new contract is signed.

The main distinction as compared to Public Cloud Hosting is that only a single customer's data! applications would be stored on a given server in the data center in case of Dedicated Hosting as opposed to the multi-tenant usage of servers by several organizations for Public Cloud.

Storage warehouse is a service offering that is provided with Dedicated/Managed hosting. It would be covered in a Dedicated Hosting services contract and be invoiced with the rest of the Dedicated Hosting services. It could also be called "offsite retention', "managed back-up" etc. It is essentially a service that addresses certain disaster recovery needs of customers."

8. The learned Counsel for the assessee Shri. PJ Pardiwala, stated that from the distribution of services of public cloud hosting services and dedicated/ managed hosting services as per agreement between the assessee and its customers, the same provides for hosting and other ancillary services. The learned Counsel for the assessee stated that apart

from merits this issue has already been settled by the co-ordinate bench of the Tribunal in the case of ITO (IT) TDS-4, Mumbai vs. People Interactive (I) P Ltd. in ITA Nos. 2179 to 2182/Mum/2009 for AY 2005-06 to 2008-09, wherein People Interactive (I) P Ltd. has availed the services of the assessee i.e. Rackspace. The fact is that People Interactive (I) P Ltd was the owner / host of www.shaadhi.com where individuals can registered and exchange the relevant information for matrimonial alliances on payment of subscription amount. People Interactive (I) P Ltd availed the services of the assessee vide a contract dated 01.01.2007, which was later on modified. The assessee Rackspace offered advance type of dedicated hosting solutions to that party and services provided by the assessee to the said party was under litigation before the AO for non-deduction of TDS and hence, the AO passed the order under section 201(1) and 201(1A) of the Act and the Tribunal finally held that the payment is neither royalty under section 9(1)(vi) of the Act nor as per Article 12 of Indo-US DTAA and Rackspace, the assessee, being having no PE in India not liable to tax in India, there is no requirement of TDS on these services. The Tribunal finally considered the agreement clauses and decided the issue vide para 7 to 9 as under:-

> *"7 We have considered the rival contention as well as the relevant material on record. We find that the payments in question were made by the assessee to Rackspace in pursuant to the contract/agreement between the parties. The CIT(A) has extracted the relevant contents/clauses of the serviced level agreement between the assessee and*

Rackspace in pars 10 & 10.1 of the impugned order as under;

> *"10. I have gone through the issue. The appellant is the owner of the popular website Shaadi.com. To maintain its website, the appellant has entered into a contract with Rackspace who provides the hosting services. There is a master, service agreement which defines "IT hosting service" and it means the information technology hosting services described in a service order and Service Level Agreement plus support. Details about the Service Level Agreement are extracted below:*
>
> *Service Level Agreement.*
>
> *Choosing a hosting provider is never easy and it seems to be risky when your site is at stake. We know that the availability of your site is of utmost importance and entrusting your website to Rackspace is something that we taken seriously. That's why we have built the hosting industry's most aggressive Service Level Agreement (SLA) to cover the multiple components that keep your site up and running.*

Rackspace's SLA is a contract between you, the customer and Rackspace. It defines the terms of our responsibility and the money back guarantees f our responsibilities are not met. We want our customers to feel at ease With their decision to move their site to Rackspace, and knowing that Rackspace takes your site's uptime as seriously as you do is imperative.

The Rackspace SLA covers three components that support the availability of your web site:

100% Network Uptime

Rackspace guarantees that its network will be available 100% of the time in a given month, excluding scheduled maintenance. Network uptime includes functioning of all network infrastructure including routers, switchers and cabling, but does not includes services or software running on your server. Network downtime exists when a particular customer is unable to transmit and receive data and is measured from (he time the trouble ticket is opened.

Rackspace Guarantee: Upon experiencing downtime, Rackspace will credit the customer 5% of the monthly fee for each30 minutes of downtime (up to 100% of customer's monthly fee for the affected server).

Infrastructure

Rackspace guarantees that the critical infrastructure systems will be available 100% of the time in a given month, excluding scheduled, maintenance. Critical infrastructure includes functioning of all power and HVAC infrastructure including UPSs, PDUs and cabling, but does not include the power supplies on customers' servers. Infrastructure downtime exists when a particular server is shutdown due to power or heat problems and is measured from the time the trouble ticket is opened to the time the problem is resolved and the server is powered back on.

Rackspace Guarantee: Upon experiencing downtime, Rackspace will credit the customer 5% of the monthly fee for each 30 minutes of downtime (up to

100% of customer's monthly fee for the affected server).

Hardware

Rackspace guarantees the functioning of all hardware components and will replace any failed component at no cost to the customer. Hardware is defined as the Processor(s), RAM, hard disk(s), motherboard. NIC Card and other related hardware includes with the server. This guarantee excludes the time required to rebuild a RAID array and the reload of certain operating systems and applications.

Hardware replacement will begin once Rackspace identifies the cause of the problem, hardware replacement is guaranteed to be complete within one hour of' problem identification.

Rackspace Guarantee: In the event that it takes us more than one your to replace faulty hardware, packspace will credit the customer 5% of the monthly fee per additional hour of downtime (up to 100% of customer's monthly fee for the affected server)"

10.1 Details about Rackspace Service Levels is extracted below;

"No matter the size of your business, you will always get the kind of support the goes for beyond the ordinary. It's truly Fanatical Support and since different businesses have different needs, we offer you two service levels — Managed and Intensive. So you can determine what kind of support works best for you, instead of us deciding for you. Regardless of which service level you go with, you'll always get all of the following, without exceptions:

Fanatical Support any time, anywhere, any way.

You dedicated Support Team with an Account Manager a td Business Development Consultant.

Direct and unlimited access to live, expert support 24x7x365, no call centre

Immediate response to your Emergency Support Tickets.

Configuration management available through your MyRackspace customer portal.

Flexibility to interact with Rackspace and your configuration based on your preference.

Eight world class data centers and the Rackspace Zero-Downtime Network.

100% Network Uptime Guarantee.

1-Hour Hardware Replacement Guarantee.

Weekly Managed Backup plus daily differential or incremental backup.

Immediate response to Down Events.

Pager and email alerts.

Managed	intensive
Experience, dedicated team Responding to your needs 24x7x365	Experience, dedicated team Responsible for health and Management of your system 24x7x365
Rapid Response to Monitoring Alerts	Integrated Planning to Prevent downtime
Expert Engineers available to Investigate and resolve your issues	Recurring knowledge of your unique environment
Fast development of standard configurations	Rackspace responsible for hosting platform (network, hardware & OS) uptime
System management tools Assist	System implementation process

in managing your configuration and interactions with Rackspace	designed to your business needs.
	Integrated process and system management tools for managing complex environments.

7.1 Thus, it is manifest from the agreement that the payments have been made for providing web hosting services with all backup, security, maintenance and uninterrupted services. There is no dispute that all the equipments and machines relating to the services provided to the assessee are under the control of Rackspace and situated outside India. When the assessee could not operate or even have no physical excess to the equipments system providing service, then the assessee would not be using the equipments but only availing the services provided by Rackspace.

8 The Hon'ble Delhi High Court in the case of Asia Satellite Telecommunications Co. Ltd. (supra) while deciding a similar issue on the point of royalty has held in paras 58 to 60 as under:

> *"In the light of our discussion explaining Explanation 2 to section 9(1)(vi) of the Act, let us proceed to*

apply these principles on the facts of the case. The starting point has to be the nature of services provided by the appellant to its customers as per the agreement arrived at between them. Keeping in view the aforesaid operation of the satellites, we revert back to the agreement entered into between the appellant and its customers. It is clear from various clauses of the agreement (and noticed above), the appellant is the operator of the satellites. It also remains in the control of the satellite. It had not leased out the equipment to the customers. On this basis, it is argued by the appellant that the equipment is used by the appellant and it is only providing and rendering services to its customers and not allowing the customers to use the process. In the case of ISRO [2008] 307 ITR 59 (AAR), the AAR has narrated in detail the process of the operation of a satellite and the role played by the transponder therein.

The following features of the agreement entered into by the appellant with its clients need to be highlighted at this stage:

(a) The appellant is a foreign company incorporated in Hong Kong and carries business of providing satellite communications and broadcasting facilities.

(b) The clients with whom the appellant has entered into agreement are not the residents of India.

(c) The appellant has launched its satellites in the orbit footprint on which it is extended over four continents including Asia and, thus, covers India.

(d) The agreement signed with the customers which are television channels, the appellant provides facility of transponder capacity available on its satellite to enable these television channels to relay their signals. These customers have their own relaying facilities, which are situated outside India. From this facility, the signals are beamed in space where they are received by a

transponder located in the appellant satellite. The transponder receives the signal and on account of the distance these signals have to travel, they are required to be amplified. After amplification frequency of signals are downlinked to facilitate the transmission of signals. This is how the signals are received over various parts of the earth spanning numerous countries including India.

(e) The outcome, thus, would entirely depend upon the question as to whether any "process" is used by the television channels and also whether a "secret process" is required to bring within the ambit of Explanation 2.

Once we keep in mind the aforesaid important aspects, it is not difficult to find the answer to the question posed. In fact, we can say that it is so provided by the AAR in ISRO [2008] 307 ITR 59 (AAR). A close scrutiny of the said ruling of the AAR would clearly reveal that where the operator has entered into an agreement for lease of transponder capacity and has not given any control over parts of satellite/transponder, the provisions of

clause (vi) would not apply. In the present case also, the appellant had merely given access to a broadband with available in a transponder which can be utilized for the purpose of transmitting the signals of the customer. In that case, after taking note in depth, the operation and the functioning of transponder, the AAR emphasized on the fact that data sent by the telecast operator does not undergo any change for improvement through the media of transponder."

8.1 Further, the Hon'ble Delhi High Court, after considering the decision of Advance Authority of Ruling in the case ISRO(supra) has observed in paras 62 to 64 as under:

> *"It is also clear from the above that the aspect of amplification of data by the transponder is taken only as additional factor, but the judgment is not entirely rested on that. This ruling further categorically demonstrates that in a case like this, services are provided which is integral part of the satellite, remains under the control of the satellite/transponder owner (like the*

appellant in this case) and it does not vest with the telecast operator/ television channels.

The position is substantially the same in the present case as well. The Tribunal has distinguished this judgment and has opined that it is not applicable because of the reason that in ISRO [2008] 307 ITR 59 (AAR), there was any amplification of the signal whereas in the present case, signals are amplified. That, to our mind, would not make any difference insofar as ultimate conclusion is concerned, inasmuch as the ruling of the Authority for Advance Rulings is not founded on the aforesaid consideration. It becomes manifest when we take note of the question posed by the Authority for Advance Rulings before answering the same. The Authority for Advance Ruling expressed this as under:

> *"The crucial question that needs to be addressed, therefore, is whether the payment made to IGL under*

the aforementioned contract constitutes consideration for the use of or right to use equipment of IGL. To answer this question, we have to discern the substance and essence of the contract as revealed from the terms of the contract document, the technical report and other facts furnished by the applicant."

On the aforesaid poser, the Authority for Advance Rulings discussed the issue and held that the transponder and the process therein are actually utilized for the satellite user for rendering the services to the customer and further that it cannot be said that the transponder or process employed therein are used by the customer.

8.2 Thus, in view of the decision of the Hon'ble Delhi High Court when the equipments were not operated, used or under the control of the assessee, then the payments made for availing the

services of Rackspace cannot be said as royalty. When the payments are not in the nature of royalty as per Indo-USA DTAA as well as per Explanation 2 (via) of Sec. 9(1) of the I T Act, then recipient of the said payments being non-resident having no PE is not liable to tax in India. Therefore, the payments in the hands of Rackspace are not taxable in India and consequently, no tax required to be deducted u/s 195 on such payment/remittance by the assessee as held by the Hon'ble Supreme Court in the case of GE India Technology Centre P. Ltd. v. Commissioner of Income-tax reported in 327 ITR 456.

8.3 We further note that for AY 2006-07, the Assessing Officer disallowed the payments made by the assessee to Rackspace for hosting charges u/s 40(a)(ia) for the reason of non deduction of tax at source while passing the assessment order u/s 143(3).

8.4 On appeal, the CIT(A) allowed the claim of the assessee vide order dated 29.1.2009 . Consequently, the Assessing Officer passed a giving effect order dated 3.12.2010 u/s 154 and accepted the claim

of the assessee in respect of the expenditure for hosting charges paid to Rackspace. Thus, it is clear that the Assessing Officer while passing the order dated 3.12.2010 u/s 154 accepted that the payment is not in the nature of royalty.

9. In view of the admitted position as the Assessing Officer has accepted the claim of the assessee regarding the expenditure on account of web hosting paid to Rackspace as well as the facts and circumstances of the case and legal position on the point as discussed above, we do not find any reason to interfere with the impugned order of the CIT(A) for the respective assessment years. Accordingly, the appeals filed by the revenue are dismissed"

9. On the other hand, the learned CIT DR, Shri Kumar Sanjay relied on the discussion and directions of DRP on both the issues.

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:

> *"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."*

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.

12. We have gone through the provisions of Article 12(3) of the India-USA 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. It 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.

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: -

> *"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."

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.

19. The next common issue is as regards to chargeability of interest under section 234B of the Act. For this assessee has raised the ground as under: -

"Ground no. 3: Erroneous levy of interest under Section 234B 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 8,528,308 under section 234B of the Act ignoring the fact that when the duty is cast on payer to withhold tax at source under section 195 of the Act, no interest under section

234B of the Act can be imposed on the payee assessee."

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 income-tax 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.

22. Similar are the issues and facts in AYs 2013-14 and 2014-15 are identical, hence, taking a consistent view, we direct the AO to apply the above decisions in these years also.

23. **In the result, these appeals of the assessee are allowed as indicated above.**

Order pronounced in the open court on 29.05.2019.

Sd/-	Sd/-
(राजेश कुमार / RAJESH KUMAR)	(महावीर सिंह /MAHAVIR SINGH)
(लेखा सदस्य / ACCOUNTANT MEMBER)	(न्यायिक सदस्य/ JUDICIAL MEMBER)

मुंबई, दिनांक/ Mumbai, Dated: 29-05-2019

सुदीप सरकार, व.निजी सचिव / *Sudip Sarkar, Sr.PS*

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //**True Copy**//

उप/सहायक पंजीकार (Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**