Sum received by US co. for providing web hosting service wasn't royalty, though involving use of scientific equipment

Summary – The Mumbai ITAT in a recent case of Savvis Communication Corporation., (the Assessee) held that Payment received for providing web hosting services though involving use of certain scientific equipment cannot be treated as 'consideration for use of, or right to use of, scientific equipment' which is a sine qua non for taxability under section 9(1)(vi), read with Explanation 2 (iva) thereto as also article 12 of Indo-US DTAA

Facts

- The assessee was an American company engaged in the business of providing information technology solutions, including, amongst other things, web hosting services. During the relevant financial period, the assessee earned income from provision of managed hosting services to Indian entities. Income so earned was claimed to be not taxable in India in view of the provisions of articles 12 and 7 of the India-USA Double Taxation Avoidance Agreement.
- The Assessing Officer took note of the fact that the services provided by the assessee was essentially in the nature of limited period contracts for hosting data and applications on the data centres maintained by the assessee, outside India, which were in the nature of specialized facilities consisting of, *inter alia,* server on which data and applications were hosted, network and hardware which facilitated the connectivity of the server with the outside world. He held that in essence the receipt was for granting the right to use the scientific equipment which was taxable in India under item (*va*) of Explanation 2 to section 9(1)(*vi*) as also article 12(3)(*b*) of Indo-US Tax Treaty.
- On appeal, the Commissioner (Appeals) deleted addition holding that payment for providing web hosting services, with all back up, maintenance, security and uninterrupted services did not amount to royalty under the provisions of the Act or the tax treaty.
- On revenue's appeal:

Held

- The very basis of the impugned addition is Assessing Officer's finding that the receipts in question were on account of use of scientific equipment, and, for that reason, giving rise to an income taxable under section 9(1)(*vi*) as also article 12(1)(*b*) of the Indo-US Tax Treaty. This finding, however, proceeds on the fallacy that when a scientific equipment is used by the assessee for rendering a service, the receipt will be construed as a receipt for use of scientific equipment. Undoubtedly, when the assessee receives an income on account of allowing a customer to use a scientific equipment, it does become taxable for the reason of its being characterized as such, but the use of a scientific equipment by the assessee, in the course of giving a service to the customer, is something very distinct from allowing the customer to sue a scientific equipment. The true test is in

finding out the answer to the fundamental question, is it the consideration for rendition of services, even though involving the use of scientific equipment, or is it the consideration for use of equipment simplicitor by the assessee? In the case of former, the consideration is not taxable, in the case of the latter, the consideration is taxable. A payment cannot be said to be consideration for use of scientific equipment when person making the payment does not have an independent right to use such an equipment and physical access to it. In the instant case also, what the assessee is providing is essentially web hosting service, though with the help of sophisticated scientific equipment, in the virtual world. The scientific equipment used by the assessee enable rendition of such a service, and such a use, which is not even by the Indian entity, is not an end in itself. In this view of the matter, even though the services rendered by the assessee to the Indian entities may involve use of certain scientific equipment, the receipts by the assessee cannot be treated as 'consideration for the use of, or right to use of, scientific equipment' which is a *sine qua non* for taxability under section 9(1)(*vi*) read with *Explanation 2* (*iva*) thereto.