

News

June 1, 2018

Flip Flop on Royalty Tax Stance Raises Eyebrows in India

By Siri Bulusu

An Indian judicial body spared a U.S. tech company from paying royalty taxes on income from its Indian subsidiary, a reprieve that contradicts a recent judgment involving Alphabet Inc.'s Google.

India's Authority for Advance Rulings said in its May 21 [ruling](#) that because the Indian subsidiary of U.S.-based Akamai Technologies Inc. lacked access to the underlying intellectual property, the income from the subsidiary doesn't amount to royalty payments.

But when Google India Private Ltd. made similar payments to Google Ireland, two separate Income Tax Appellate Tribunals deemed them to be royalty payments—causing practitioners to question India's position on the tax treatment of such transactions. A lack of clarity could result in tax litigation due to inconsistent approaches by the tax department both at a policy level and judicial level, they said.

"It's diametrically opposite to the Google ruling on a substantially similar fact pattern on the royalty finding and addresses many of the same arguments raised by the tax department," Meyyappan Nagappan, leader of taxation of digital economy at Nishith Desai Associates, told Bloomberg Tax in a May 30 email.

Seeking Certainty

Akamai Technologies entered into an agreement with Akamai Technologies Solutions India Pvt. Ltd. in 2010 to sell its product in India. The company has product "comprising of 73,000 secure servers equipped with proprietary software and deployed in 70 countries," according to the ruling.

In 2012, India changed the definition of “royalty” to include more types of transactions. Akamai Technologies sought an advance ruling in 2013 to have tax certainty for the upcoming assessment year, a move practitioners said they likely made because there was no judicial guidance at the time.

The tax department said that the case is similar to that of a software distributor. The department claimed the transaction was a transfer of copyright, a “grant of right to use trademarks and brand features,” and amounted to a grant of distribution rights, according to the May 21 ruling. Meanwhile, Akamai Technologies claimed “it is not a software distributor but a technology company,” the ruling said.

The Authority for Advance Rulings disagreed with the tax department’s argument, saying “We are therefore of the view that the amount received by the applicant towards the Solutions would not be in the nature of ‘Royalty’.”

Google Comparison

In the Google case, a May 11 [judgment](#) stated that it was “beyond doubt” that Google India had been provided a license to use intellectual property for which it was making payments to Google Ireland—and that the India-Ireland tax treaty also classified the transaction as a royalty.

“The Authority for Advance Rulings has distinguished the case from Google India on the grounds that there are factual differences in how the taxability of the transaction will be determined,” Prashant Kotecha, head of direct tax and transfer pricing at K.C. Mehta & Co. told Bloomberg Tax June 1.

Making it Clear

Cross-border payments have become an increasingly puzzling aspect of international taxation since such transactions can be subject to a variety of tax treatments depending on how they are categorized under a country’s tax law.

Technology companies are often caught in litigation since digital transactions lack judicial precedence, but practitioners say any company involved in a cross-border payment for marketing and distribution purposes could face scrutiny from India’s tax department.

While the ruling will provide some comfort to multinational corporations involved in cross-border payments for intellectual property, the tax department has made it clear that they will seek to tax similar transactions, Nagappan said.

“From their arguments in the Akamai Technologies and Google cases, the stand from the tax department appears to be clear that such transactions are taxable,” he added.

Until official guidance or judicial precedent is set, companies are better off opting for an advance ruling for tax certainty, Kotecha said.

“The taxability of digital transactions is being tested and highlighted now but the situation is still too immature, so even if it takes up to 10 years to get an advance ruling that’s the best way for companies to anticipate their taxes,” Kotecha said.