

## **Tax treatment for cloud computing needs scrutiny, says law firm**

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It may be difficult to arrive at any concrete conclusion on the appropriate tax treatment of new business models like cloud computing involving multiple (and intricately connected) features or transactions, says a note on cloud computing issued by law firm Nishith Desai Associates.

### **New phenomenon**

Although e-commerce taxation has been rapidly evolving in India, cloud computing, being a relatively new phenomenon, has neither been tested by the Courts nor scrutinized by the Indian tax authorities, the note says.

In certain situations, an argument may be raised that payments for certain forms of cloud computing services may be classified as fees for technical services, the tax implications of which are similar to that of royalty, the note says.

But in standard structures where the client does not exercise any control over the cloud server and merely procures certain platform, infrastructure or support services, the consideration paid to a foreign service provider should normally be treated as business profits. This would be taxable in India only if the service provider has a permanent establishment (PE) in India, says the note.

### **Royalty**

In the case of e-commerce, the tax authorities have been adopting a position that the income received by foreign service providers in most service models are in the nature of royalties. Hence, they would attract a withholding tax in India at the rate of around 10 per cent. However, if it is characterized as business profits, such income would be taxed in India only if the foreign entity has a PE or a business connection in India, the note points out.

Under the Income Tax Act, the definition of royalty covers both consideration paid for the right to use certain IP rights (such as copyrights, patents, secret formulae etc) and the right to use scientific equipment. A similar definition appears in several tax treaties signed by India. From a broad analysis of this definition, it may be possible to interpret it in a manner that would cover a number of cloud computing models, says the note from Nishith Desai.

### **Direct taxes code**

The impact of the new Direct Taxes Code proposed to replace the Information Technology Act from 2012, on new age technologies such as cloud computing would also have to be carefully examined, says the note. For instance, the draft DTC seeks to tax technical services rendered to an Indian resident even if the services are not rendered in India. "From a policy perspective, it is necessary for law-makers to ensure that tax and other regulatory factors do not act as an impediment to the growth of innovation and technology," says the note.

As the Indian tax authorities and Courts grapple with the tax implications of emerging e-commerce models, it is necessary to arrive at solutions that further the principle of neutrality in the tax treatment of e-commerce and ordinary commerce, said the note.

Cloud computing is the practice of the offer of hardware, software and tools by third parties or cloud service providers. The client may not own the hardware software or tools but pay for them based on usage.

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