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Businesses Seek More Clarity on Royalty Payments in India

By Benjamin Parkin

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- *Indian court rules against royalty tax on digital payments to Amazon*
- *Practitioners say digital businesses need certainty about what's taxable*

Digital companies want more certainty and guidance on tax and royalty charges for India-based operations as they become increasingly embroiled in court disputes with authorities.

Recent rulings from the Indian courts and tax departments have sent contradictory messages to digital companies, creating uncertainty about what they consider to be royalty payments that are taxable, practitioners said. This inconsistency and lack of clarity add to the cost of doing business in India, they said.

Amazon Web Services Inc. is the latest company that's faced the court over royalties. But while the court ruled in its favor—finding that payments made from an India-based technology company to Amazon Web Services Inc. for use of its cloud computing services weren't subject to royalty tax—practitioners warn the tax department is likely to appeal the matter, involving the company in a drawn-out court proceeding.

A case involving Alphabet Inc.'s Google earlier this year went the other way, meanwhile, with a court finding that the company was due to pay royalty tax. Google said it would appeal the ruling.

Because many digital business models are relatively new to tax authorities, tax officials have argued their activities are subject to new levies—such as royalty taxes. Tax advisers expect these cases to make their way up to the Supreme Court.

“With the nature of business evolving at such a fast pace, what is and what does not constitute royalty needs to be examined,” said Pallav Pradyumn Narang, a partner at CNK RK & Co.

The resurgence of these types of cases can pose an obstacle to digital companies doing business in India, lest they risk getting caught up in long-running and costly litigation, they said.

Given that many technology companies also pay for cloud computing services provided by the likes of Amazon, Apple Inc. and Microsoft Corp., the Amazon ruling presents an obstacle to an important avenue for digital tax collection, according to Shailesh Kumar, a director at Nangia Advisors LLP. Were the tax department to win out, however, those multinationals could also find royalty taxes chipping away at their India-based revenue.

In the case of Amazon, officials sought tax from the company, EPRSS Prepaid Recharge Services India P. Ltd, on the idea that it was benefiting from access to Amazon's property and equipment, making it a royalty payment subject to tax.

Pune's Income Tax Appellate Tribunal's Oct. 24 finding, however, suggested that the company was merely paying Amazon a fee to use its servers, and not benefiting from the broader transfer of knowledge and technology that would incur the 10 percent tax. Moreover, the court ruled against the retrospective nature of the tax department's case against EPRSS, which was based on a rule change that happened after the company had started making the payments in question.

Obstacle to Digital Companies

Taxing these digital transactions as royalty payments is one of a number of ways that India has sought to increase revenue from the digital economy. The country in 2016 introduced a digital withholding tax, known as an equalization levy, and this year announced a new measure to help tax companies that don't have a physical presence in the country. A number of other countries are taking their own steps to boost digital taxes.

A spokesperson from the tax department didn't respond to a request for comment. EPRSS also didn't respond to request for comment. A spokesperson from Amazon Web Services declined to comment.

Contradictory Rulings

Google's case stems from payments Google India Private Ltd. made to Google Ireland for the use of its copyrighted AdWords advertising software. A tribunal in May held that the company owed almost \$40 million.

Soon after, a separate judicial body ruled that U.S.-based Akamai Technologies Inc. wasn't subject to royalty taxes on similar payments. The seeming contradiction puzzled tax professionals.

A spokesperson for Google didn't respond to a request for comment. The company told Bloomberg Tax in May that it would appeal the ruling in the High Court.

"This ruling is an inaccurate representation of our business operations in India. The order is also a clear departure from previous judgments on the issues and is not in line with India's double taxation avoidance agreement," the spokesperson said.

Practitioners said that while the facts of each case are different—particularly Google's, which they said was more complex—these sorts of issues repeatedly occur, sometimes unnecessarily.

"There should be some guidance, these issues should stop cropping up every year," said Meyyappan Nagappan, leader of the international tax team at Nishith Desai Associates. "From a company's perspective, this is a tax cost and an uncertainty cost."

In Retrospect

The Pune court also ruled that it was impossible for EPRSS to have withheld the royalty tax, given that the tax department based its case a retrospective amendment to tax law. India expanded the definition of royalty payments in a 2012 amendment, while this case was based on payments made starting in 2010.

India's tax department has controversially used retrospective amendments to its laws to seek more taxes from multinationals. Famous cases involving Cairn Energy Plc and Vodafone Group Plc have gone all the way to international arbitration. This case showed that such demands could be unfeasible, Nagappan said.

Nangia said in a note that the "tribunal has made its mark by elaborating its conclusion on the ever disputed topic of applicability of retrospective amendments."

The firm said it agreed with the court's finding, that retrospective amendments couldn't be used to demand withholding taxes on payment that were already made. The company that should have deducted the tax can't go back to the business it paid and ask for a refund after the fact, said Nangia's Kumar.

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