

SATURDAY INTERNATIONAL TAX GYAN !!!

#taxmadeeasy

**Engineering Analysis Centre Of
Excellence Pvt Ltd vs. CIT
(Supreme Court)**

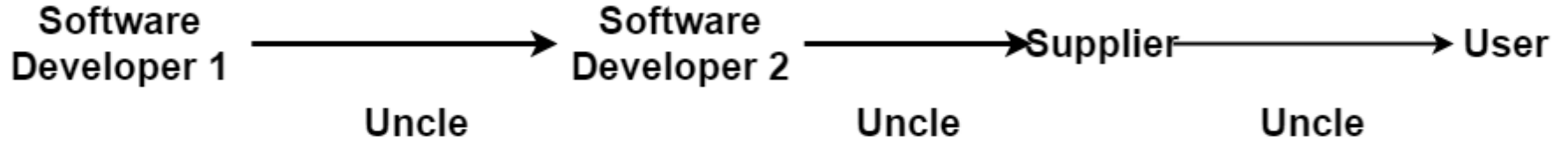
**Payment to Non-resident for Software - Not taxable as
Royalty: Supreme Court's Landmark Ruling Sets
Controversies to Rest**

#Taxinpic



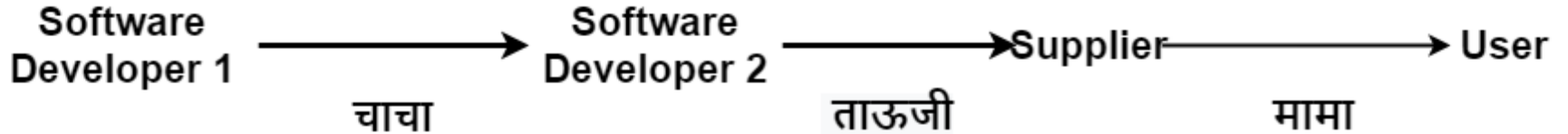
How Harry sees the Relations

1



How राम sees the Relations

2



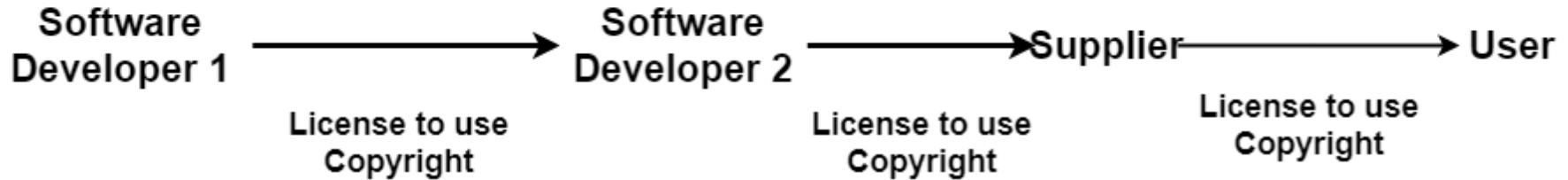
Same same but different

#Taxinpic



1

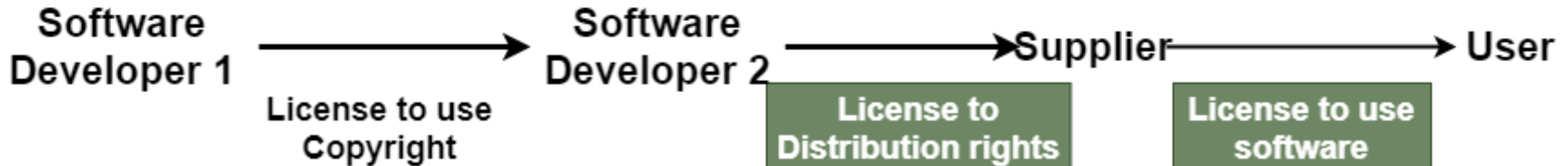
How AO sees the Transaction



2



How Hon'ble SC sees the Transaction



Royalty ✓

Royalty ✗

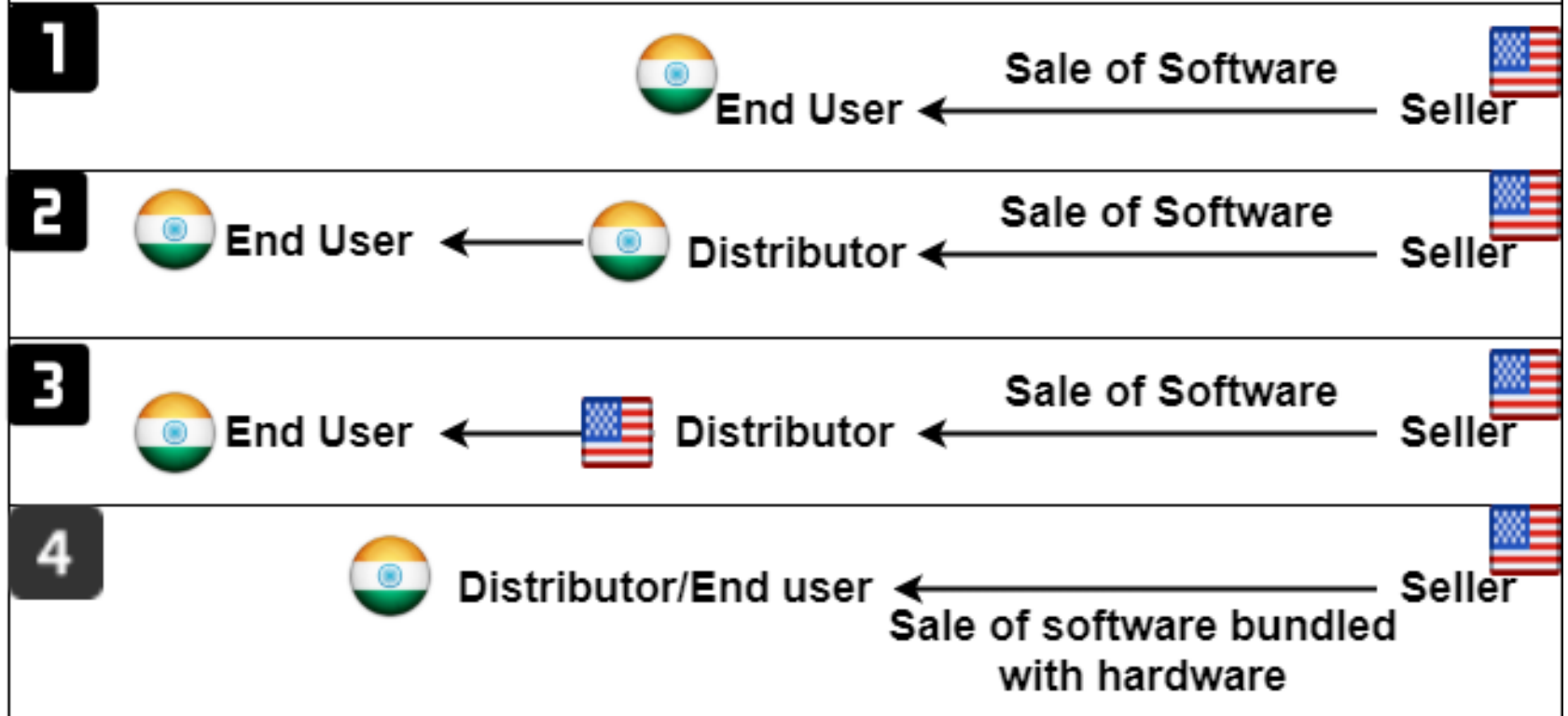
Fact of the Case

- The assessee, is a resident Indian end-user of shrink-wrapped computer software, directly imported from the USA.

<u>103 Applicant's</u> Contention	Revenue's Contention
<p>It's not a Royalty, actually it's a purchase of Goods. As Seller's Permanent establishment not in India. No taxability arise in India on this transaction.</p>	<p>The transaction between the parties is a transfer of copyright which amounts to be payment for the Royalty and TDS required to be deducted by the Indian importer. (Article 12(3) of India-USA DTAA read with section 9(1)(vi) of the Act)</p>

ISSUE

Whether Software sold by Non Resident to Indian buyer in any of these conditions will be considered as payment of Royalty??



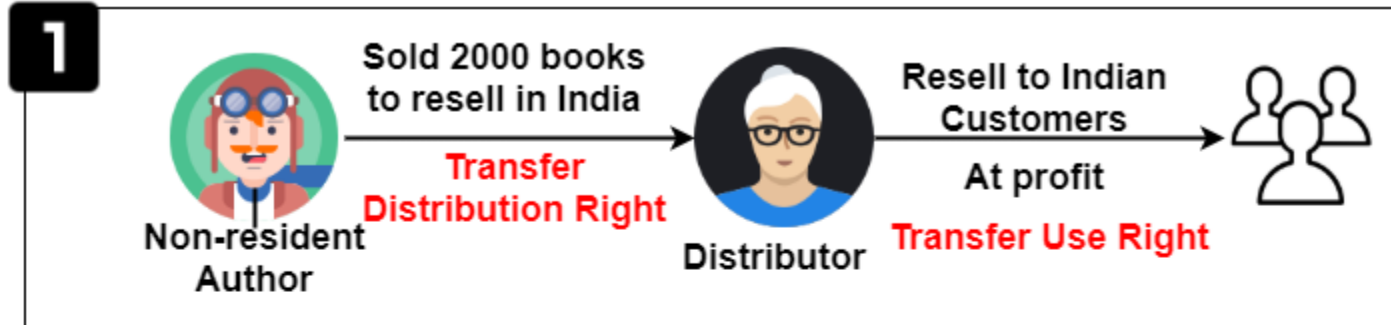
LET'S UNDERSTAND THE CONCEPT

1. Transfer of Copyright

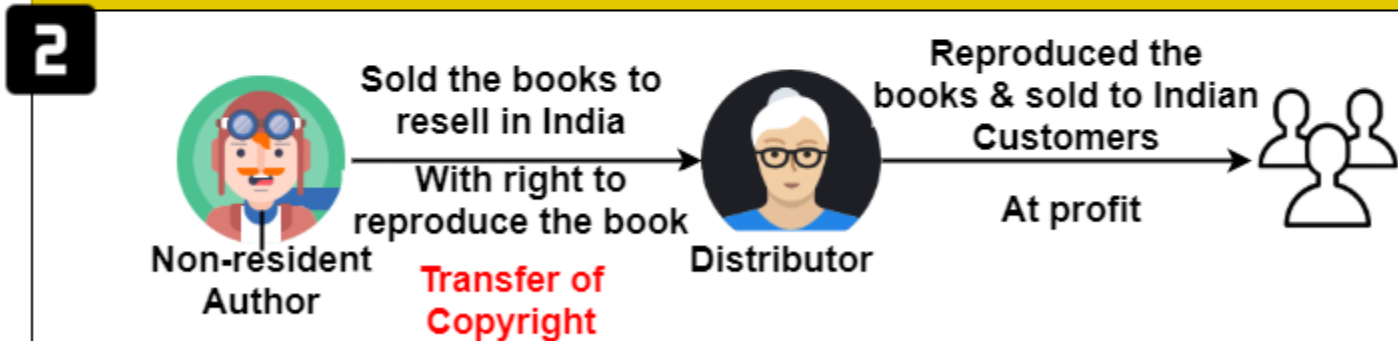
Key pointers where a **transfer of licence is not transfer of copyright by Hon'ble SC:**

- Copyright is an **exclusive right** which includes the right to restrict others from performing certain acts
- As per Section 30 of the ICA, the owner of copyright in a "literary work" (includes computer program) is entitled to **grant any interest in his rights by way of a license** in return for a royalty payment.
- Ownership of copyright in a work vis-a-vis ownership of the physical material in which copyrighted work is embodied are **mutually exclusive**.
- A copyright is said to be transferred if the **right to do acts defined in section 14** of the Copyright Act is also transferred.
- **Right to produce** and **right to use computer software** are distinct and separate rights.
- In cases where a license is granted, an infringement of copyright under the ICA would take place only when there is any use of the rights contrary to the license so granted.

1. Example of Transfer of Copyright



In this case, no Copyright has been transferred to Indian distributor by way of license or otherwise as he doesn't have the right to reproduce the books.



In this case, Copyright has been transferred to Indian distributor by way of license or otherwise, as he has exclusive right to reproduce the book as he want in the territory mentioned by the license.

2. Analysis of Agreements

End user License agreement (EULA): is a contract that governs the use of the software or app which describe the rights.

The court gone through various distribution agreements and observed that:

- **Distributor/reseller** granted only a **non-exclusive, non-transferable** licence to resell computer software, as it expressly stipulated that no copyright in the computer programme is transferred either to the distributor or to the ultimate end user.
- **End-user-** It does not have any further right to **sub license or transfer**, nor is there any right to reverse-engineer, modify, reproduce in any manner otherwise than permitted by the licence to the end-user.
- Therefore, what is paid by way of consideration is the price of the computer programme **as a goods**.

The licence granted vide the EULA is not a license in terms of section 30 of the ICA but is a licence which imposes restrictions or conditions for the use of the computer software.

3. Taxability under the Act v. DTAA

- **IT Act- Sec- 9(1)(vi)**- States that income by way of 'Royalty' would be deemed to accrue or arise in India.If-
Explanation 2- "royalty" to be a consideration for the transfer of all or any rights (including the granting of a license) or use of any copyright of literary work.
- DTAA: "royalty" to mean consideration for the **use of, or the right to use**, any **copyright** of a **literary**, artistic or scientific work. (Narrow definition)

Since the license granted to distributors and end users **does not create any interest or right in the software**, grant of such license would not amount to the "use of or right to use" of **copyright** and, hence, it would **not qualify as royalty under the Tax Treaty as well as under the Act**(upto 2012).











- **Explanation 4** to section 9(1)(vi) inserted by the Finance Act, 2012, to provide that transfer of all or any rights includes transfer of all or any **rights for use of a computer software**, expands the definition of royalty- Now Taxable as royalty under the Act. But assessee is free to opt beneficial provision under ITA or DTAA (Sec 90).

Ruling

The Hon'ble Supreme Court has clarified that:

- Distribution agreements/EULAs **do not create any interest or right** in such distributors/end-users, which would amount to the **use of or right to use any copyright.**
- Therefore, any of the 4 categories will **not be considered as payment of Royalty** and **no TDS is required to be deducted by the Indian Buyer.**

Ruling

Not Taxable as a Royalty		Example
1	 End User ← Sale of Software Seller 	Zoom
2	 End User ←  Distributor ← Sale of Software Seller 	Microsoft Office
3	 End User ←  Distributor ← Sale of Software Seller 	Windows sold by foreign distributor
4	 Distributor/End user ← Sale of software bundled with hardware Seller 	Printer software

1st & 4th is majorly used in the current Day & age

Our Comments

- **Applicability of equalization levy-** As per the Union budget 2021 it has been proposed that royalty and FTS payments which are taxable under the Act would not be subjected to any equalization levy. Going forward, taxpayers would need to evaluate the impact of this decision on royalty and FTS payments from an equalisation levy.
- **Application for Refund-** After this landmark judgement, the taxpayers should first and foremost revisit their positions for royalties paid in the past and apply for refunds, wherever possible and applicable.
- **Proposal by UN Subcommittee-** It releases an update note on Art. 12 of UN Model Tax Convention for inclusion of computer software payments in definition of royalties that means now DTAA may add this provision similar to explanation 4 of the Act, which will bring the transaction into the ambit of tax. Link for the same proposal-

<https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-09/Revised%20discussion%20draft%20final.pdf>

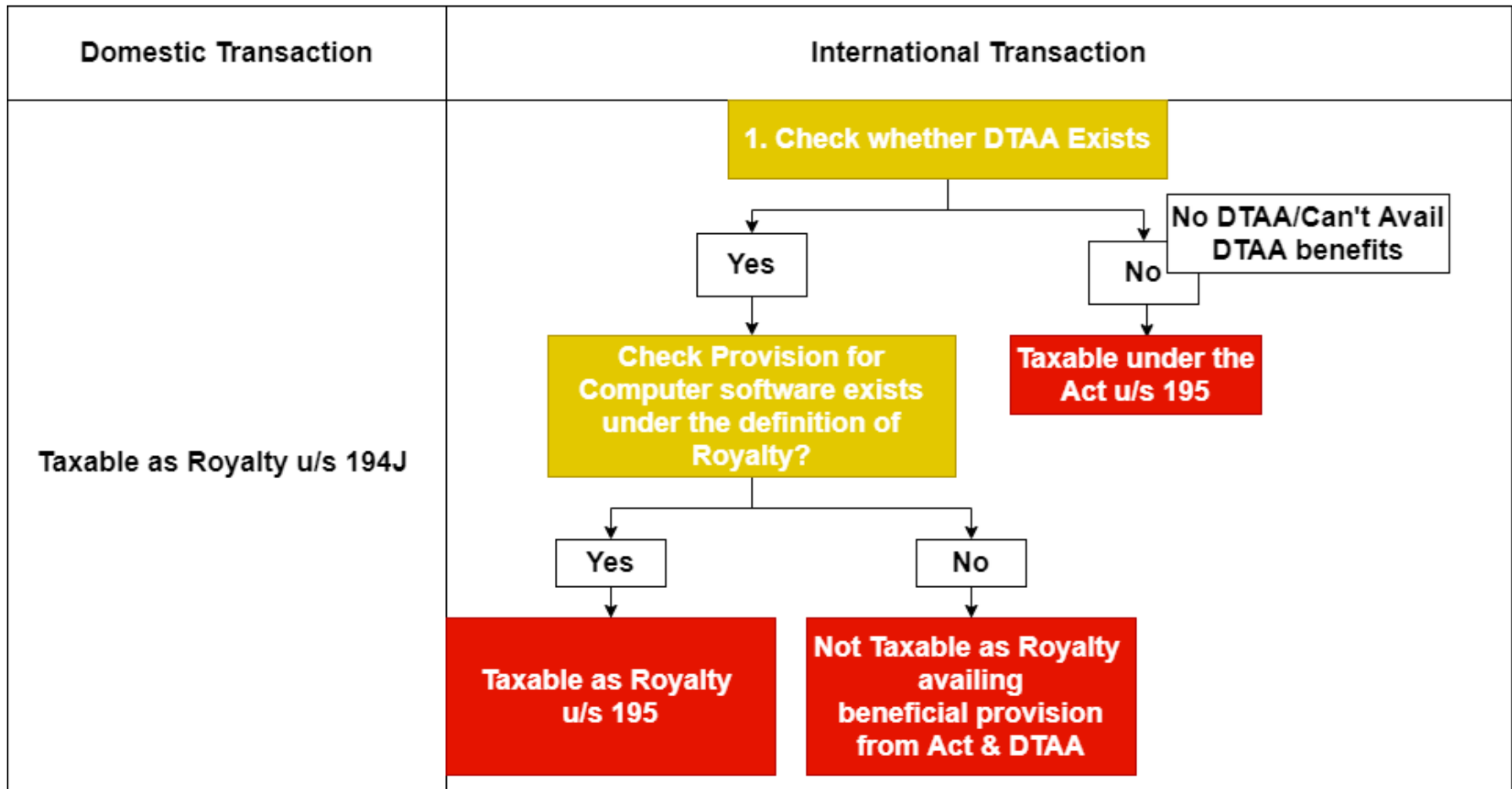
Our Comments

- **Can you avail DTAA Benefits-** Post Finance Act, 2012 by insertion of explanation 4 in Section 9(1)(vi), scope of the Act becomes wider and taxability of this disputed transaction of cross border software purchase comes into the ambit of taxation but this will not impact the definition of DTAA. So, if one needs to take the benefit of DTAA he need to check-
 - The taxpayer must **obtain the TRC** (Tax Residency Certificate).
 - Whether **Treaty exists** between the countries.
 - Whether such Treaty has **covered Computer software as royalty**. Payment for software is covered as part of royalty example in 5 treaties namely Morocco, Russia, Turkmenistan, Malaysia and Tobago. Therefore, transaction with these country would attract Royalty taxability under DTAA too.

In the practical scenario, if we are purchasing software online through an intermediary website, it would be impossible to collect TRC from a vendor we do not know. hence we need to deduct tds on every transaction.

Current Scenario

Transferred use or right to use Computer software (Except in case of Capital Gain)



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