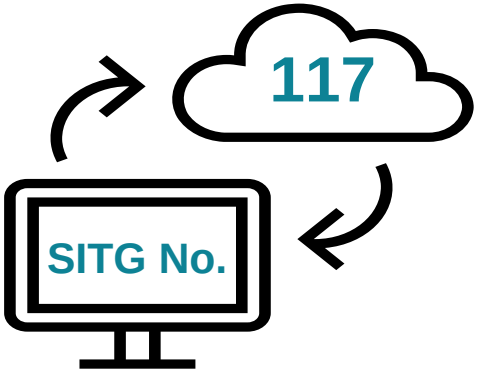

SATURDAY INTERNATIONAL TAX GYAN !!!

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MOL Corporation v. ACIT

Grant of right to install and use software & providing cloud computing software does not include providing copyright of said software to clients and the same would not be taxable as royalty.

[2022] 140 taxmann.com 121

Date: 03.09.2022

Facts of the Case

- Assessee is a US based company, earned revenue from **sale of software** to its Indian clients. Assessee also provided the **cloud computing** infrastructure to its Indian clients through **subscription agreement**.
- Gracemac Corporation is a wholly owned subsidiary of Microsoft Corporation got merged with MOL Corporation. All the rights and obligations of Gracemac got merged into the affairs of MOL Corporation.
- 'Microsoft Corporation' granted exclusive license to manufacture and distribute Microsoft products to Gracemac Corporation which, in turn, granted non-exclusive rights to its wholly owned subsidiary, Microsoft Operations Pte. Ltd., Singapore.
- M/s Microsoft Regional Sales Corporation (MRSC) has been appointed as a distributor of Microsoft products in Asia by MO, Singapore.
- A.O. contends that the **revenue earned by MRSC** would be taxable as **royalty** in India in the hands of assessee.

Assessee's Contention

❖ Assessee contends that:

- **Sale of software** is not covered under definition of Royalty defined in Article 12 of India-USA DTAA as the transaction is sale of 'copyrighted article' and not 'copyright' and accordingly this is business income and assessee does not have PE in India and thus such income is not taxable in India and
- **Cloud based services** were based on patents/copyright but subscribers did not get any right of reproduction, thus, subscription fee will not be considered as royalty under article 7 of India USA DTAA.

Revenue's Contention

- The A.O. has held that the Revenue earned and received from sale of software by MRSC is taxable in India as royalty in the hands of the assessee.

- Assessing Officer contends that revenue earned in the form of **subscription fee** would be **royalty** under article 12 of DTAA and would be taxable in India.

*(2010) 40 SOT 51

Legal Provisions related to DTAA

As per **Article 12** of India USA DTAA-

3. The term **"royalties"** as used in this Article means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any **copyright** of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof ; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(*c*) or 3 of Article 8.

Legal Provisions related to DTAA

7. (a) Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State. Where, however, the person paying the royalties or fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for included services was incurred, and such royalties or fees for included services are borne by such permanent establishment or fixed base, then such royalties or fees for included services shall be deemed to arise in the Contracting State in which the **permanent establishment** or fixed base is situated.

(b) Where under sub-paragraph (a) royalties or fees for included services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for included services relate to services performed, in one of the Contracting States, the royalties or fees for included services shall be deemed to arise in that Contracting State.

RULING

- The **sale of software is a sale of 'Copyrighted Article'** and not 'Copyright' and accordingly, the revenue from sale of software is in the nature of business income not taxable under Article 7 of India - USA DTAA in the absence of a Permanent Establishment of the Appellant in India.

- **Since grant of right to install and use software did not include providing copyright of said software to clients, revenue earned from said sale would not be taxable in hands of assessee as royalty in India. Thus, we are of the opinion that the sale of software product does not give rise to the royalty income**.

- The sale of software product which will not giving rise to royalty income as held in the case of:
  - **Engineering Analysis Centre of Excellence (P.) Ltd . [Supreme Court]** (Link of previous SITG has been provided for your reference)
  - DIT v. Infra Soft Ltd.
  - In the assessee's own case in ITA No. 1554/Del/2016 dated 13-4-2022 and decided the issue in favour of the assessee for Assessment Year 2012-13.

RULING

- **In assessee's own case, Tribunal held that even though cloud based services were based on patents/copyright but subscribers did not get any right of reproduction, thus, subscription fee was merely a consideration for online access of cloud computing services.**

- Thus, subscription fees received towards cloud services would not be taxable in hands of assessee as royalty.

- The Co-ordinate Bench, by following the ratio laid down in the case of:
  - Salesforce.com Singapore Pte. Vs. Deputy Director of Income Tax (Link of previous SITG has been provided for your reference)
  - Dy. DIT v. Savvis Communication Corpn. {[2016] 69 taxmann.com 106}

  In the light of above binding decisions, since there is no distinguishing facts, the grounds of appeal has to be allowed.

OUR COMMENTS

- The Landmark judgement of Supreme court in case of Engineering Analysis Centre of Excellence (P.) Ltd. has made it very clear that if a software is purchased with a non-exclusive right to use the software then same cannot be considered as royalty as per the various DTAA.

- However, one need to note that as per explanation 4 of section 9(1)(vi) of the Income tax act, software is still covered under definition of royalty and hence if one is not able to take benefit of DTAA or the DTAA does not exist then the assessee purchasing such software should deduct TDS as per income tax act.

- Cloud based products are also software and hence are grossly covered in the judgement of Engineering Analysis. However, the issue which many people will face with cloud based software provider is to get TRC, as there is no point of contacts in such online platforms and if one does not get TRC it will be difficult to get benefit of DTAA and without DTAA benefit such software service will be liable for tax withholding under Income Tax Act.

Section/Article	Article 7 & 12 of DTAA and section 9 of Income Tax Act
DTAA/Country	India - USA
Court	Delhi - Trib.
Date of decision	05.07.2022

Note: Case law name in Red- in favour of the revenue, Green- In favour of the Assessee, Orange = Partial

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