SC Ends 20-yr-old Dispute Over Software Royalty

Rules that cross-border payments made for purchase of software can't be taxed as royalty

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New Delhi: The Supreme Court on Tuesday ended a 20-year-old software-royalty tax dispute, ruling that cross-border payments made to foreign software companies and distributors for the purchase of software cannot be taxed as royalty.

Such payments made by resident Indian end users and distributors to non-resident computer software manufacturers or suppliers, as the consideration for the resale and use of computer software through end-user licensing or distribution agreements, are "not the payment of royalty for the use of copyright in the computer software", the court said.

"...the same does not give rise to any income taxable in India," it said, adding that as a result the end users or distributors were not liable to deduct any tax at source on the payment.

The judgement was delivered by a bench led by Justice RF Nariman and also comprising Justices Hemant Gupta and BR Gavai.

The ruling will have a far-reaching impact as it becomes the law of the land, said Rakesh Nangia, chairman of professional services firm Nangia Andersen India. "This issue has been quite convoluted and remained an apple of discord for multiple years. The ruling of the Supreme Court was much awaited and will put to rest open litigation on this issue."

Though many cross-border software payments would be relieved from royalty tax, these transactions could still be covered under the expanded equalisation levy that was introduced in April last year to tax digital transactions, Nangia said.

This ruling also depicts that Indian courts shall not deny treaty benefit to the deserving taxpayers, he added.

The income tax department had characterised these payments made for software purchase as royalty.

The tax authorities had argued that the Indian entity was granted the rights to utilise the intellectual property or copyright in the software and consequently the payment for such purchases amounted to royalty income for the seller.

However, software companies had argued that these transactions were sale simpliciter and did not entail licensing of any copyright.

The non-resident owner retains the proprietary rights and the use of the software by the Indian company is limited to making backup copy and redistribution, they contended.

Consequently, they argued, payment received for the sale of computer software was business income and in the absence of a business presence or permanent establishment of the seller in India, such business income was outside the ambit of taxation.

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SC RULING

Payments to non-resident firms for software not taxable as royalty

INDU BHAN
New Delhi, March 2

THE SUPREME COURT on Tuesday ruled that payments made to non-residents for software purchase can't be taxed as royalty, setting at rest a long-standing row. This means tax liability of foreign software seller without a permanent establishment in India would reduce to the 2% equalisation levy introduced via Finance Act 2020, from the 10% royalty tax, which the Indian buyer has hitherto been liable to withhold.

The ruling will lower the cost of software purchases for Indian firms as the overseas sellers may chose to lower prices, taking advantage of the tax relief. Software firms such as IBM India, Samsung Electronics, GE India, Hewlett Packard India, Mphasis and others, which import software for sale in India, are among the principal beneficiaries.

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Payments by Indian firms for foreign software not taxable: SC

INDIVJAL DHASMANA
New Delhi, 2 March

The Supreme Court has ruled in favour of companies by rejecting the income tax (I-T) department's stand that the money paid by Indian companies for use of software developed by foreign firms amounts to royalty and is taxable in the country.

The apex court has settled the long-pending dispute between companies such as Samsung Electronics, IBM, Hewlett Packard, Mphasis, Sonata Software, GE India & others and the tax department.

The court held that there is no liability for Indian companies to deduct tax at source with respect to purchase of software from foreign companies.

The Bench, comprising Justices R F Nariman, Hemant Gupta and BR Gavai, said the amount paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs (end user licence agreements)/distribution agreements, is not payment of royalty for the use of copyright in computer software, and it does not give rise to any income taxable in India.

Explaining the case, Rakesh Nangia, chairman of Nangia Andersen India, said the I-T department had broadly characterised the payments made to non-residents for software purchase as royalty.

Taxpayers, on the other hand, contended that such payments for the sale of software are in the nature of business income in the hands of the non-resident, Nangia said.

As such, companies argued that in the absence of business connection/permanent establishment of the non-resident seller in India, such business income would not be taxable in India.

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This issue was contested before various courts in the past.

Two of the most important and conflicting rulings were in the case of Samsung Electronics where the Karnataka High Court had ruled in favour of the revenue department and Delhi High Court's ruling in the case of Ericsson favouring taxpayers.

Various courts have taken divergent views on this matter, resulting in vast uncertainty and ambiguity in the minds of taxpayers.

Nangia said the apex court has brought a happy end to the 20-year-old software-royalty tax dispute by pronouncing the verdict in favour of taxpayers.

"The ruling will have a far-reaching impact as it will now become the law of the land. This issue has been quite convoluted and remained an apple-of-discord for several years. The ruling of the Supreme Court will put to rest open litigation on software taxation and lead to refund to taxpayers," he said.

₹77,815 crore

paid in instalments spread over 16 years after a two-year moratorium.

In terms of mix, of the total 488.35 MHz spectrum bought by Jio, 74.60 MHz was in the 1800 MHz band, and 280 MHz was in the 2300 MHz band. Of the total 355.45 MHz bought by Bharti, the mix was as follows: 48.85 MHz in the 800 and 900 MHz bands; 86.6 MHz in the 2100 and 1800 MHz bands; and 220 MHz in the 2300 MHz band.

the states may be asked to foot part of the vaccination cost.

SC ruling: Payments to non-resident firms for software not taxable as royalty

Tax liability of foreign software supplier without Indian PE would reduce from 10% royalty tax to 2% equalisation levy

Ruling to lower cost of software induction for **Indian firms across sectors as overseas software sellers** might chose to cut rates, taking advantage of tax relief

After the SC ruling, such software firms have now been exempted from deducting TDS for purchase of software from foreign software suppliers.

Vishal Malhotra, national tax leader-TMT at EY India, said: "This is a welcome judgment which not only brings certainty on the two-decade-long debate, but also vindicates the non-taxability stand on software payments by reinforcing supremacy of tax treaties entered into by two sovereigns over the domestic law."

Earlier court rulings on the dispute were conflicting. In the case of Samsung Electronics, Karnataka High Court had ruled in favour of the taxman while the Delhi High Court, in the Ericsson case, upheld the taxpayer's contention. The subsequent rulings by other HCs have been divergent.

"Though many cross-border software payments would be relieved from royalty tax, these transactions could still be covered under the expanded equalisation levy that was introduced in April last year," said Rakesh Nangia, chairman, Nangia Anderson India.

Settling the 20-year dispute, a Bench led by Justice RF Nariman said "...the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through the End-User Licence Agreements/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons (resident Indian importers) referred to in Section 195 of the Income Tax Act were not liable to deduct any TDS under Section 195 of the Income Tax Act."

Deciding around 86 appeals and cross-appeals both by the software companies and the income tax department led by Engineering Analysis Centre of Excellence Pvt Ltd vs Commissioner of Income Tax, the top court while citing the definition of royalties contained in Article 12 of the double taxation avoidance agreements (DTAAs) clarified that, "there is no obligation on the persons mentioned in Section 195 of the Income Tax Act to deduct tax at source, as the distribution agreements/EULAs in the facts of these cases 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."

According to the judgment, "the provisions contained in the Income Tax Act (Section 9(1)(vi), along with explanations 2 and 4 thereof), which deal with royalty, not being more beneficial to the assessees, have no application in the facts of these cases." It said that the End User Licence Agreements of the software do not transfer or assign the copyright over the software and what is given the distributor is only a non-exclusive, non-transferable licence to resell computer software. It is being expressly stipulated that no copyright in the computer programme is transferred either to the distributor or to the ultimate end-user, the SC said in its 226-page judgement.

The income tax department termed payments made to non-residents for software purchase as royalty. The rationale for this stance has been that when software is sold, the incorporated programme is licensed to the end user. The taxman has also contended that since the Indian entity is granted the rights to exploit the software copyright, the payments for such purchases amount to royalty income for the seller.

Taxpayers have opposed this view, saying that these transactions are sale simpliciter and do not entail licensing of any copyright. The non-resident owner retains the proprietary rights in the software and the use of the software by the Indian company is limited to making backup copy and redistribution, they argued. Payment received for sale of computer software is business income and in the absence of a business presence or permanent establishment of the seller in India, such business income is outside the ambit of taxation, companies argued.

SUPREME COURT RULING

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INDU BHAN
NEW DELHI, MARCH 2

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Software firms such as IBM India, Samsung Electronics, GE India, Hewlett Packard India, Mphasis and others, which import software for sale in India, are among the principal beneficiaries.

After the SC ruling, such software firms have now been exempted from deducting TDS for purchase of software from foreign software suppliers.

The ruling will lower cost of software purchases for Indian firms as overseas sellers may choose to lower prices, taking advantage of the tax relief

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Cross-border payments for use of software not taxable as royalty: SC

Buyer only gets the right of use, not the intellectual property of the software

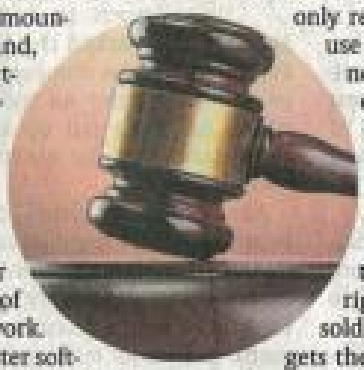
KRISHNADAS RAJAGOPAL
New Delhi, March 2

The Supreme Court today held that Indian companies need not deduct tax for the amount they pay foreign manufacturers and suppliers for use or re-sale of computer software through end-user licence agreements (EULA).

In a relief for Indian buyers, a three-judge Bench led by Justice Rohinton F. Nariman said the consideration paid by them for use or sale of computer software cannot be considered a payment of "royalty for the use of copyright in the computer software".

The 223-page judgment will impact software majors such as IBM India, Sasken Communications Tech, Sonata Information Technology, Rational Software Corporation India, Samsung Electronics, and Engineering Analysis Centre of Excellence Pvt. Ltd.

The judgment was based on cross appeals by the Revenue authorities and assessees alike on the question of whether the money paid by Indian buyers to foreign, 'non-resident' software suppliers amounted to royalty and, thus, tax deductible at source under Section 195 of the I-T Act.



Justice Nariman reasoned that payment of royalty is only for exclusive use of copyright of a work. Here, the computer software is sold in the form of a CD to an Indian buyer under a non-exclusive licence. Again, the Indian buyer only receives the right to use the software. He does not get any copyright on the software. Hence, the amount paid for a computer software from a foreign manufacturer does not qualify as royalty for which tax should be deducted at source.

Right to use software

"When, under a non-exclusive licence, an end-user gets the right to use computer software in the form of a CD, the end-user only receives a right to use the software and nothing more. The end-user does not get any of the rights that the owner continues to retain... It is wrong to say that when a copyrighted article is sold, the end-user gets the right to use the intellectual property rights embodied in the copyright which would therefore amount to transfer of an exclusive right of the copyright owner in the work," Justice Nariman elaborated.

The judge it followed up with a simple illustration: "An obvious example is the purchaser of a book or a CD/DVD, who becomes the owner of the physical article, but does not become the owner of the copyright inherent in the work, such copyright remaining exclusively with the owner."

The judgment covers four categories of purchases and use of foreign computer software. One, software purchased directly by an end-user, resident in India, from a foreign, non-resident, supplier or manufacturer;.

Two, resident Indian companies acting as distributors or resellers, by purchasing the software from foreign suppliers.

Three, wherein the distributor is a foreign vendor, who, after purchasing the software from another foreign seller, resells it to resident Indian distributors or end-users.

And, four, where the software is built onto hardware and sold as an integrated unit/equipment by foreign suppliers to resident Indian distributors or end-users.

Background p10

SOFTWARE ROYALTY TAX DISPUTE

I-T Department role

- Broadly characterised the payments made to non-residents for software purchase as royalty.
- It was based on the slant that when a software is sold, the incorporated program is licensed to the end user
- Averred that the Indian entity is granted the rights to exploit the intellectual property or copyright in the software.
- Consequently, the payment for such purchases amounts to royalty income for the seller.

What taxpayers have persistently contended?

- These transactions are sale simpliciter and do not entail licensing of any copyright.
- The non-resident owner retains the proprietary rights in the software and the use of the software by the Indian company is limited to making backup copy and redistribution.
- Payment received for sale of computer software is business income
- In the absence of a business presence or permanent establishment of the seller in India, such business income is outside the ambit of taxation.

Legislative arrangement

- Retrospective amendment introduced via Finance Act 2012 to extend the applicability of provisions for royalty.
- It explicated that irrespective of channel via which software gets transmitted, payments for a right to use computer software would be taxable as royalty income.
- Taxpayers argued clarification was against the provisions of tax treaties

Litigations

- In 2005, the income tax department sent notices to several taxpayers for payments made on import of software
- The earliest cases involved Lucent Technologies Hindustan Ltd., Samsung Electronics Company Ltd, and Sonata Software Ltd
- In the past, the issue saw legal battle with two most important and conflicting rulings
- In the case of Samsung Electronics Karnataka HC ruled in favour of the Tax Department
- However in the case of Ericsson, Delhi HC ruled in favour of taxpayers
- Various courts have taken divergent views on this matter, resulting in vast uncertainty and ambiguity in the minds of taxpayers

Appeal before Supreme Court

Total of 107 appeals, including that from Samsung Electronics Co, IBM India, Hewlett Packard India, Mphasis, Sonata Software, GE India, Lucent Technologies Hindustan, and others

Experts' take

This issue has been quite convoluted and remained an apple-of-discord for multiple years. The ruling of the Supreme Court was much awaited and will put to rest open litigation on this issue. Though many cross-border software payments would be relieved from royalty tax, these transactions could still be covered under the expanded equalisation levy that was introduced in April last year. This ruling also depicts that Indian courts shall not deny treaty benefit to the deserving taxpayers.

Rakesh Nangia, Chairman, Nangia Andersen India

This is a welcome judgement which not only brings certainty on the two decade long debate, but also vindicates the non-taxability stand on software payments by reinforcing supremacy of tax treaties entered into by two sovereigns over the domestic law.

- Vishal Malhotra, National Tax Leader - TMT, EY India