



CA. Mayur Mehta



CA. Sangam Aggarwal

Association of Professionals

presents

live session on

Jurisprudence on Taxability of

Computer Software

by

CA. Mayur Mehta, Ahmedabad

Wednesday, 27th January, 2021 at

4 pm onwards

JURISPRUDENCE ON TAXABILITY OF COMPUTER SOFTWARE

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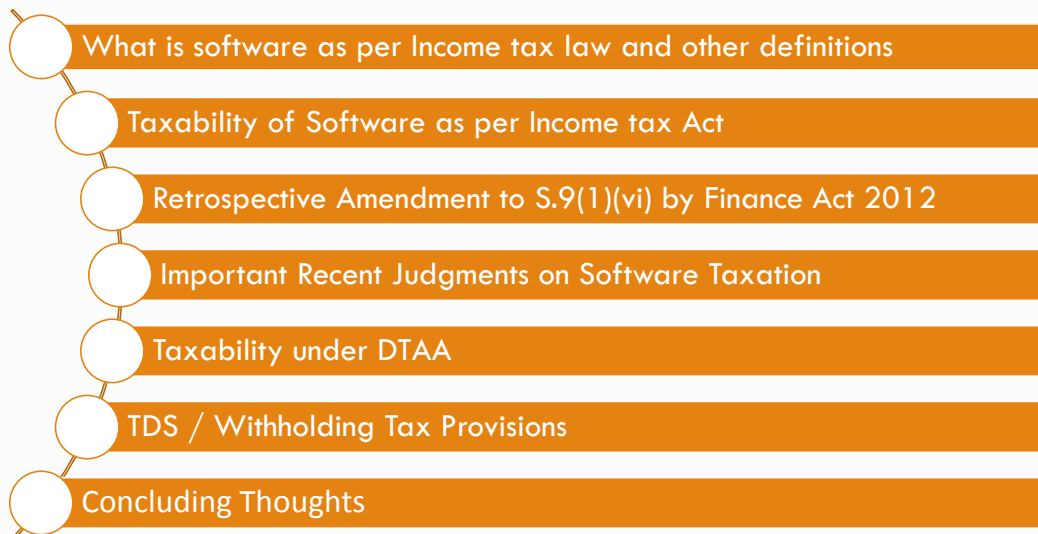
BRAIN TEASERS

Are these taxable in India?

- Downloading of songs, movies, games
- Viewing TV Channels
- Downloading anti virus software
- Downloading business information report like DNB
- Website / hosting charges
- Domain name registration
- Access to cloud storage
- Online database like journals, e-zines, reports
- Downloading and using Teams, Zoom, Meet and other such video conferencing applications
- Payment by OTT media like Netflix, Hotstar, Zee5 for movie streaming rights
- Subscription of Netflix, Hotstar, Zee5 etc.
- Supply of drawing, designs (technical / architectural)
- Vedantu / WhiteHat Jr. / GIGL

At the end of session you should be able to answer these questions

Scope of Presentation



Definitions of Computer Software

S.9(1)(vi)

[Explanation 3.—For the purposes of this clause, “computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.]

S.80HHE

Explanation.—For the purposes of this section,—

(a) ...

(b) “computer software” means,—

(i) any computer programme recorded on any disc, tape, perforated media or other information storage device; or

(ii) any customised electronic data or any product or service of similar nature as may be notified by the Board,

which is transmitted or exported from India to a place outside India by any means;

Definitions of Computer Software

Wikipedia

Software is a collection of instructions and data that tell the computer how to work. This is in contrast to physical hardware, from which the system is built and actually performs the work. In computer science and software engineering, computer software is all information processed by computer systems, including programs and data. Computer software includes computer programs, libraries and related non-executable data, such as online documentation or digital media. Computer hardware and software require each other and neither can be realistically used on its own.

Oxford Advanced Learner's Dictionary

Software is a programme used with a computer (together with their documentation), including programme listings, programme libraries, and user and programming manuals.

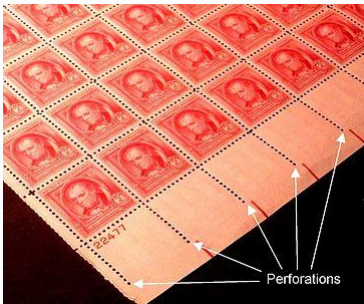
Definitions of Computer Software

Off-the-shelf or Shrink-wrap Software

Commercial off-the-shelf products are packaged solutions which are then adapted to satisfy the needs of the purchasing organization, rather than the commissioning of custom-made, or bespoke, solutions.

Perforation [used in "perforated media" in S.9(1)(vi)]

A small hole or row of small holes punched in a sheet of paper, e.g. of postage stamps, so that a part can be torn off easily.



Section 9(1)(vi) - Royalties

S.9(1)(vi)

Income by way of Royalty payable by:

- (a) the Government or
- (b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or
- (c) A person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India

Section 9(1)(vi) - Royalties

S.9(1)(vi)

Explanation 2.—For the purposes of this clause, “royalty” means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head “Capital gains”) for—

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- [(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;]
- (v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting; or
- (vi) the rendering of any services in connection with the activities referred to in 5[sub-clauses (i) to (iv), (iva) and (v)].

Cases treating Software Licence as Royalty

CIT vs Samsung Electronics Co. Ltd. 345 ITR 494 (Kar)

CIT v. Synopsis International Old Ltd. 212 TAXMAN 454 (Kar)

Gracemac Corporation (Microsoft), v. Asstt. Director of Income Tax 008 ITR (Del-Trib) 0522 (2011)

- Taxable as Royalty under Income Tax Act
- Taxable also under DTAA
- Copyright or Copyrighted Article
- Providing software amounts to use of “Process”
- Software is a literary work
- TCS (SC judgment) cannot be relied upon
- OECD MTC cannot be relied upon

Definition of Copyright

S.14 of Copyright Act 1957

(a) ...

(b) in the case of a computer programme,—

(i) to do any of the acts specified in clause (a);

(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental.

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Cases treating Software Licence as NOT Royalty

ADIT v Baan Global BV (Mum ITAT) 2016 ITL 4124

DIT v Nokia Networks OY (Del HC) 253 CTR 0417 (2012)

DDIT v Reliance Communications (Mum ITAT) 2018 ITL 332

- Held not taxable as Royalty under Income Tax Act
- Not taxable under DTAA by virtue of absence of clause in relevant Article
- Purchase of Copyrighted Article and not Copyright itself

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Explanation 4*

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Memorandum to Finance Act 2012 says:

“Some judicial decisions have interpreted this definition (definition of royalty) in a manner which has raised doubts as to whether consideration for use of computer software is royalty or not;...Considering the conflicting decision of various courts in respect of income in the nature of royalty and to restate the legislative intent, it is further proposed to amend the Income-tax Act.....”

**inserted by FA 2012 wref 01/06/1976*

Circular F No.500/111/2009-FTD-I(Pt.) dated May 29, 2012

- Assessments completed prior to April 1, 2012, should not be reopened only on account of clarificatory amendments which are effective from April 1, 1976 and April 1, 1962.
- Clarification not applicable to those cases where notice of reopening has already been issued prior to April 1, 2012
- Further, assessments made earlier, which stand validated due to the clarificatory amendments, would be enforced.

Asia Satellite Telecommunications Co. v DIT 332 ITR 340 (2011)

- Use of Transponder in Satellite
- Uplinking / Downlinking of Signals
- Use of Process? Secret process? - Irrelevant

International Tax commentaries treat as service and not rental of equipment.

*Explanation 5**

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

- (a) the possession or control of such right, property or information is with the payer;
- (b) such right, property or information is used directly by the payer;
- (c) the location of such right, property or information is in India.

*inserted by FA 2012 wref 01/06/1976

Leased Line Charges

Held not taxable

Dell International Services (2008) 172 Taxman 418 (AAR)

Infosys Technologies 139 TTJ Bang. UO 18

Held taxable

Verizon Communications Singapore Pte Ltd. [2014] 361 ITR 575 (Mad)

Madras HC held that having regard to retrospective amendment payment for connectivity services liable as Royalty.

Explanation 6*

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

*inserted by FA 2012 wref 01/06/1976

Bentley Nevada LLC v JDIT (Del Trib) 2018

Composite sale of hardware and software

Held that entire consideration is business income and not royalty. In the absence of PE cannot be taxed in India.

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Online Database Access

Favouring Assessee

Dun and Bradstreet Espana – business of supplying business information reports – Not royalty

Cadila Healthcare (Abd Trib) – Not royalty as only access to literary database and not licence to use copyright

Favouring Revenue

Wipro Ltd. (Kar) – Right to use online journal is Royalty.

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Other Issues

Domain Name Registration

Godaddy.com (Del Trib) - Held as Royalty u/s 9(1)(vi) Exp. 2 (iii) relying on Trademark related judgments in Satyam Infoway Ltd. (2004) and Tata Sons Ltd. (2001)

Supply of Drawing / Designs

CIT v/s Davy Ashmore India Ltd. [1991] (190 ITR 626) (Calcutta HC) - Held that non resident seller does not retain any property in them, outright sale – Not royalty as per Art. 13 of India UK DTAA

Applicability for S.40(a)(ia)

In Sonata Information Technology, Mumbai observed that Expl. 4 which had been inserted with retrospective effect was not relevant for Sec. 40(a)(ia), which deals with disallowance of deduction for expenses on failure to deduct tax from domestic payments. ITAT noted that as per Sec. 40(a)(ia), the term 'royalty' shall have the same meaning as provided in Expl. 2 of section 9(1)(vi).

Supreme Court on Tata Consultancy Services 2004

- Sales tax case of Andhra Pradesh Sales Tax Act
- Software incorporated on media – held as goods
- Liable to sales tax

In Ericsson case, relying on TCS, Delhi HC held that it is supply of tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty.

However, Karnataka HC in Samsung case held that TCS ruling was in the context of Andhra Pradesh Sales Tax and thus, could not be relied upon to determine whether software payment amounts to 'royalty' under the Income-tax Act or Indo-US DTAA.

Taxability Under DTAA

Definition of Royalty in OECD MTC

Article 12 (2) - Royalties

The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

Taxability Under DTAA

Definition of Royalty in UN MTC

Article 12 (3) - Royalties

The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

Taxability Under DTAA

Royalty as per Article 12 of India-US 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.

Taxability Under DTAA

Held as Royalty

Samsung Case – India UK DTAA

Reference has to be made to the respective law regarding definition of 'Copyright', namely, Copyright Act, 1957, in India, wherein it is clearly stated that "literary work" includes computer programmes, tables and compilations including computer databases. ... The payment (for purchase of shrink wrapped software) would constitute 'royalty' within the meaning of Article 12(3) of the DTAA.

Millenium IT Software – India Srilanka DTAA

Held as Royalty as per Art 12.

Taxability Under DTAA

Held as NOT Royalty

DIT v Ericsson AB – Even if Royalty in Exp 2, it is not Royalty in Art 13 Indo – Sweden DTAA

This is so because the definition in the DTAA is narrower than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case.

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Other Issues

Use of Software – Whether process

Gracemac Corporation – Yes

Til Team Telecom - No

Whether literary work

Samsung – Yes

Millenium IT – Yes

Ericsson – Yes

Citrix Systems - Yes

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TDS Provisions

S. 194J – Circular 21/2012 13/06/2012

No TDS if

- ✓ From Resident – Subsequent transfer
- ✓ No modification done
- ✓ Previously TDS deducted
- ✓ Declaration obtained

TDS Provisions

S. 195

Rates in Force Sec 2(37A)

(37A) "rate or rates in force" or "rates in force", in relation to an assessment year or financial year, means—

(i).....

(ii)

(iii) for the purposes of deduction of tax under section 194LBA or section 194LBB or section 194LBC or section 195, the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year or the rate or rates of income-tax specified in an agreement entered into by the Central Government under section 90, or an agreement notified by the Central Government under section 90A, whichever is applicable by virtue of the provisions of section 90, or section 90A, as the case may be;

TDS Provisions

Circular 728

It has been represented to the Board that when making remittances of the nature of royalties and technical fees, tax is being deducted at source at the rates specified in the Finance Act of the relevant year, without taking into account the special rates for taxation of such income provided for under the Double Taxation Avoidance Agreement with the country concerned.

The expression 'rates in force' has been defined in section 2(37A) of the Income-tax Act. Under sub-clause (iii) of section 2(37A), for purposes of deduction of tax under section 195, the expression is to mean the rate or rates of income-tax specified in this behalf in the Finance Act in the relevant year, or the rates of tax specified in a Double Taxation Avoidance Agreement entered into by the Central Government, whichever is applicable by virtue of the provisions of section 90 of the Income-tax Act, 1961.

It is hereby clarified that in view of the provisions of sub-section (2) of section 90 of the Act, in case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, the tax should be deducted at the rate provided in the Finance Act of the relevant year or at the rate provided in the DTAA, whichever is more beneficial to the assessee.

Concluding Thoughts

TAG and CBDT High Powered Committee

OECD in 2001-02 formed Technical Advisory Group (TAG) on Treaty Characterization to examine 28 types of e-commerce payments. It reported that software payment does not constitute Royalty under DTAA.

CBDT also formed a High Powered Committee and gave report in 2001 – Differing from TAG report it opined that consideration for use of software should constitute Royalty both under Income-tax Act and DTAA with USA and UK.

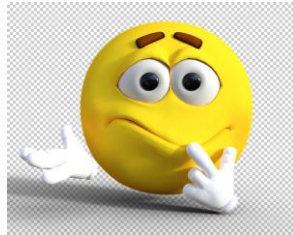
DTAA Where Software Payment is Expressly Included as Royalty

India – Russia DTAA, India – Morocco DTAA, India - Turkmenistan DTAA, India –Romania DTAA, India – Kazakhstan DTAA, India - Kyrgyz Republic DTAA, India - Trinidad and Tobago DTAA.

PROBABLE ANSWERS TO BRAIN TEASERS

Are these taxable in India?

- Downloading of songs, movies, games - T
- Viewing TV Channels - T
- Downloading anti virus software - T
- Downloading business information report like DNB – NT
- Website / hosting charges - T
- Domain name registration - T
- Access to cloud storage - NT
- Online database like journals, e-zines, reports - NT
- Downloading and using Teams, Zoom, Meet and other such video conferencing applications – T
- Payment by OTT media like Netflix, Hotstar, Zee5 for movie streaming rights - T
- Subscription of Netflix, Hotstar, Zee5 etc. - T
- Supply of drawing, designs (technical / architectural) - NT
- Vedantu / WhiteHat Jr. / GIGL - T



Questions?

Please email your queries to CA MAYUR MEHTA on mayur@samasa.ca. You will receive prompt reply.

I can be reached at (M) 9662926629.

Thank You

Disclaimer: The views expressed are speaker's personal views and should not be construed as those of income tax department or ICAI. The views should also not be taken as professional advice.