# Tax Wire

## Consideration for sale of software - Royalty or not: Delhi tax tribunal ruling

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adwith CONSULTING

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## Background

It is a known fact that buying licenses for software usage is a very common business transaction. It is also fairly common for Indian entities to buy such software from foreign companies. Commercially, payment for such licensing could have different connotations. However, the tax authorities in India have been consistently taking a view that such payments would be construed as payment towards royalty. The implication is that, if it amounts to royalty then withholding tax on such payments have to be done irrespective of whether the seller has a Permanent Establishment in India or not. Additionally, if software licenses are brought into India and resold, it may result into multiple layers of taxation on the same consideration.

This matter has been a subject matter of multiple judicial rulings in the past. One such recent ruling was delivered by Hon'ble Delhi Tax tribunal in the case of **Qliktech International AB v/s DCIT**[1].

We present the analysis of this ruling in this edition of TaxWire.

## Facts

1. Qliktech International AB, a foreign Company incorporated in Sweden and is engaged in the business of sale of software products and rendering information technology services. (hereinafter referred to as tax payer)

2. This company has entered into an agreement with its subsidiary QlikTech India Private Ltd. for onward sale of shrink-wrapped software to the end users/ customers in India as per the distribution/ license agreement. As per the said agreement Qlik India will promote and resell QlikTech products to the end users within the prescribed territory in accordance with the terms and conditions set forth in the agreement.

3. Qliktech International AB filed its return of income on March 30, 2016 declaring NIL income. The tax officer passed an order holding that the entire receipts amounting to Rs. 7,01,62,491/- from sale of software products is taxable as royalty under Article 12 of the India-Sweden Double Taxation Avoidance Agreement and u/s 9(1)(vi) of the Act.

## The Conflict

The tax payer preferred an appeal before the first appellate authority, raising the following grounds:

1. Whether the consideration received by Foreign Company on account of sale of shrink-wrapped software will be considered as consideration received for the sale of a process or for the transfer of information of commercial or industrial nature.

2. Whether the sale of software by the Appellant to end-users through distributors/ re-sellers must be treated same as the supply of software by the Appellant to the end-users directly.

3. Whether the sale of software is in the nature of sale of "copyrighted article" or is in the nature of transfer of "copyright".

4. Whether the sale of software satisfies the definition of Royalty as mentioned in section 9(i)(vi) of the Act or as mentioned in India – Sweden DTAA.

The first appellate authority, Commissioner Income Tax (Appeals) ruled in favour of the tax department. The tax payer carried the dispute further to the tax tribunal - Delhi.

[1] [2020] 122 taxmann.com 255 (Delhi - Trib.)

## The Analysis

The tax tribunal while holding that consideration received on account of shrink-wrapped software will **not be treated as Royalty and should be treated as business income** relied on the decision of Hon'ble Delhi High Court in the case of **DCIT v. Infrasoft Ltd. 264 CTR 329**. Some of the highlights of the said ruling which was followed by the tax tribunal are as under:

- to treat the consideration paid by the Licensee as royalty, it is to be established that the licensee, by making such payment, obtains all or any of the copyright rights of such literary work.
- Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article". Copyright is distinct from the material object, copyrighted. Copyright is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript.
- Copyright or even right to use copyright is distinguishable from sale consideration paid for "copyrighted" article. This sale consideration is for purchase of goods and is not royalty.
- The license granted by the Assessee is limited to those necessary to enable the licensee to operate the program. The rights transferred are specific to the nature of computer programs. Copying the program onto the computer's hard drive or random-access memory or making an archival copy is an essential step in utilizing the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analyzing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business income in accordance with Article 7 of DTAA.
- The High court had also stated that they are not in agreement with the decision of Hon'ble Karnataka High court in the case of Samsung Electronics Co. Ltd that right to make a copy of the software and storing the same in the hard disk of the designated computer and taking backup copy would amount to copyright work under section 14(1) of the Copyright Act and the payment made for the grant of the licence for the said purpose would constitute royalty.
- The High court had also dealt with the amendment brought out to section 9(1)(vi) will not apply, as long as the tax treaty is not amended.

Since the same matter was already decided in favour of the tax payer in earlier years based on the above quoted Hon'ble Delhi High court ruling, Delhi tax tribunal ruled in favour of the tax payer in the current case also.

## Advith Comments

The debate around whether payment to software – shrink wrapped or otherwise, is royalty or not – continues to rage! The retrospective amendment brought out to the definition of royalty in 2012 attempted to negate the rulings which were in favour of the taxpayers. However, since the tax treaties have definitions which are favourable to the interpretation that a distinction need to be done between 'copyright' and 'copyrighted article', taxpayers can still take this position depending on each tax treaty, which is applicable to them.

Hopefully, the matter maybe put to some rest when the Apex Court of the country delivers its verdict on many SLPs which are pending for judgement on this matter.

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