

Copyrighted software not taxable royalty on resale

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The taxability of payments by importers for software imports from non-resident suppliers is a vexed question on which courts had earlier given conflicted rulings. The question has now been settled by the Supreme Court in the recent cases grouped under the title of *Engineering Analysis Centre of Excellence Private Limited v Commissioner of Income Tax and Anor.*

The cases related to the import from non-resident suppliers of software in four categories:

- where software was purchased directly by end-users;
- where distributors purchased software from non-resident suppliers and resold it to end-users;
- where non-resident distributors purchased software from non-resident sellers and sold it to distributors or end-users, and
- where software was installed on hardware sold by non-resident suppliers to Indian distributors or users.



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The question was whether the consideration paid to non-resident suppliers was a royalty, requiring tax to be withheld by Indian importers.

Tax law allows residents of countries with which India has a double tax avoidance agreement (tax treaty) option to be taxed under Indian law or under the treaty law. Under the treaty law, business income of non-residents can be taxed in India only if they have a permanent establishment (PE) in India. However, royalties paid to non-residents can be taxed in India even if they have no PE. In the present case none of the non-resident suppliers had a PE in India. Therefore, the question was whether amounts paid by importers to non-resident suppliers were royalties.

A royalty is defined in tax treaties as the consideration for the right to use any copyright of a literary, artistic or scientific work in connection with any patent, trademark, design, plan or secret formula. The revenue considered that the import of software was a transfer of copyright, and therefore payment for it was a royalty, requiring the withholding of tax. It cited provisions of the [Copyright Act](#) under which the copyright owner has the right to reproduce the work and issue, sell or rent the copies. It argued that, as the import of software included a licence to use it, the consideration paid was a royalty.

The taxpayers submitted that they were non-exclusive distributors who purchased off-the-shelf copies of the software from non-resident suppliers for sale to Indian end-users under remarketer agreements (RA). The end-users' licence agreements (EULA) were between the non-resident suppliers and end-users. The RAs gave the importers no rights in the copyright owned by the suppliers. The transfer of copyright in an original work is different from the transfer of a copyrighted article. The EULAs gave end-users only a limited licence to use the software without any right to sub-licence or make copies. The payments to non-resident suppliers were not royalties, but the proceeds of the sale of goods.

The court held as follows:

- the liability to withhold tax arises only if the amounts remitted to the non-resident suppliers are chargeable to tax in India;
- the provisions of tax treaties prevail over those of domestic law. Therefore, the definition of a royalty in the tax treaty must be considered;
- a computer program is defined in the [Copyright Act](#) as a set of instructions in words or codes to cause a computer to perform a particular task;
- copyright is the exclusive right to do or authorise the doing of certain acts in respect of a work, including the right to copy or modify it;

- when the copyright owner assigns a right in the copyright for consideration, the assignee becomes the owner of only the assigned rights;
- the RAs show that the distributors were granted only non-exclusive, non-transferable licences to resell the software. No other right was granted to the distributors or end-users. End-users were granted the mere right to use the software without any rights to copy or modify it;
- there is a difference between the right to reproduce or modify software and the mere right to use it, and
- the consideration paid by importers is for the right to resell the software in India.

The court held that the consideration paid by importers to non-resident suppliers for the resale or use of computer software was not payment of royalties. It was for the purchase of copyrighted articles, in other words, a business expenditure. There was thus no liability on importers to withhold tax.

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