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Indian Tribunal: Payments for Software Not Royalties Under Singapore Treaty

A foreign company selling ''off-the-shelf'' software to an Indian company can't be charged withholding tax in India under the royalty provisions of a bilateral tax treaty because the product is a sale of goods rather than a license to use the copyright, the Mumbai Income Tax Appellate Tribunal ruled.

The tribunal decided against the income tax authority on an issue that has seen various state high courts pronounce differing verdicts over recent months.

Although the tribunal's decision went in favor of the taxpayer, Capgemini Business Services (India) Ltd., it won't be the last time the issue is called into question. A pending Supreme Court ruling involving Samsung Electronics Co. Ltd. could offer the final decision on how cross-border software sales involving an Indian business should be taxed and in which jurisdiction.

Facts of the Mumbai Case. In its Feb. 29 ruling, the Mumbai tribunal said that off-the-shelf sales of software by a Singapore-based company to an Indian entity should be treated as ''a sale of a good'' and not as a ''grant of license to use.'' As such, the payment for the goods can't be considered as a royalty under the India-Singapore tax treaty, it said. The payment is therefore not liable for withholding tax in India, it said.

Capgemini, an Indian company with a registered office in Mumbai, accounted for a one-time purchase of software from QAD Singapore Pvt. Ltd. as an expense for tax purposes in tax year 2007-2008. The tax authority found the payment to the Singapore company was for the use of copyright and thus a royalty subject to withholding tax in India. The dispute reached the tribunal (*Capgemini Business Services (India) Ltd. v. Assistant Commissioner of Income Tax*, (ITA No. 7779/M/2011).

Finding that the definition of royalty in the India-Singapore treaty was more beneficial to the company than under the Indian Tax Act, the tribunal said the treaty would prevail as per Section 90 of the Act and the principle laid down by the Supreme Court in an earlier 2003 case (*Union of India v. Azadi Bachao Andolan*, 2003). In addition, the Delhi High Court said that ''amendments to domestic law cannot be read into treaty provisions without amending the treaty itself'' in a Feb. 8 ruling (32 ITM, 2/18/16).

Next, because literary works are not explicitly defined in the treaty, the tribunal applied India's Copyright Act 1957 and found that though a computer program is a literary work, a one-time purchase of an off-the-shelf program is like a sale of goods—not a copyright payment—and thus falls under Article 7 (business profits) of the tax treaty. Since QAD Singapore doesn't have a permanent establishment in India, the payment isn't taxable in India, it said.

Echoing Infrasoft Ruling. The tribunal's decision reflected a recent ruling by the Delhi High Court in a case involving Infrasoft Ltd. (*Director of Income Tax v. Infrasoft Ltd.*) that concerned the India-U.S. double tax treaty. In that case, the court said that having a copyrighted item doesn't mean copyright has been transferred.

Following the precedent set by the Delhi High Court in *Infrasoft Ltd.*, the Mumbai tribunal's Judicial Member Sanjay Garg said the ''assessee is entitled to the fair use of the work/product including making copies for temporary purpose for protection against damage or loss even without a license provided by the owner in this respect and the same would not constitute infringement of any copyright of the owner of the work even as per the provisions of Section 52 of the Copyright Act, 1957.''

Outlook Uncertain. Rajesh H. Gandhi, partner at Deloitte Haskins & Sells LLP in Mumbai, told Bloomberg BNA in a March 9 e-mail that the tribunal's ruling is a positive development for taxpayers following an earlier

ruling by the Income Tax Appellate Tribunal on the same issue that found in favor of the tax authority.

However, the ruling won't provide relief for Samsung, which is appealing a Karnataka High Court (Bangalore) judgment on the same issue that said software payments should be taxable as royalties, Gandhi said.

In *CIT v. Samsung Electronics Co. Ltd.*, the Karnataka High Court considered provisions in domestic law and India's double tax treaties with France, Sweden and the U.S. It ruled that ''payments of any kind in consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work'' is deemed to be ''royalty.''

The controversy on this aspect hasn't been put to rest, Mumbai-based chartered accountants firm Vispi T Patel & Associates told Bloomberg BNA via e-mail March 10. Various State high courts have pronounced differing verdicts on how to tax payments made to foreign entities for software products. Since there is jurisprudence on both sides of the case with the Delhi High Court deciding in favor of the taxpayer and the Karnataka High Court siding with the revenue authorities, the issue is still to be resolved.

Many hope the question will be finally answered when the Supreme Court delivers its verdict in Samsung's appeal against the Karnataka High Court's decision. However, a hearing date for this case hasn't yet been announced.

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The Mumbai Income Tax Appellate Tribunal's decision in Capgemini Business Services (India) Ltd. v. Assistant Commissioner of Income Tax is at http://src.bna.com/dft.

The Delhi High Court ruling in Director of Income Tax v. Infrasoft Ltd. is at http://src.bna.com/dfv.

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