



Equalisation Levy and Royalty

CA. N.C. Hegde – CCM ICAI

Direct Tax Refresher Course of WIRC

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Statistics & Background

Digital Advertising Market in India

JAN
2021

DIGITAL ADVERTISING MARKET: VALUE GROWTH

YEAR-ON-YEAR CHANGE IN THE VALUE OF THE DIGITAL ADVERTISING MARKET BY AD FORMAT BETWEEN 2019 AND 2020



INDIA

YEAR-ON-YEAR CHANGE
IN TOTAL DIGITAL AD SPEND



+3.9%

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YEAR-ON-YEAR CHANGE IN
DIGITAL SEARCH AD SPEND



+7.3%

statista

YEAR-ON-YEAR CHANGE IN
SOCIAL MEDIA AD SPEND



+5.4%

YEAR-ON-YEAR CHANGE IN
DIGITAL BANNER AD SPEND



+0.7%

statista

YEAR-ON-YEAR CHANGE IN
DIGITAL VIDEO AD SPEND



+6.4%



YEAR-ON-YEAR CHANGE IN
DIGITAL CLASSIFIED AD SPEND



-8.9%




Internet Users in India

JAN
2021

OVERVIEW OF INTERNET USE

KEY INDICATORS OF INTERNET ADOPTION AND USE

 USER NUMBERS NO LONGER INCLUDE DATA SOURCED FROM SOCIAL MEDIA PLATFORMS, SO VALUES ARE **NOT COMPARABLE** WITH PREVIOUS REPORTS



INDIA

TOTAL NUMBER
OF INTERNET USERS
(ANY DEVICE)



624.0
MILLION

INTERNET USERS AS
A PERCENTAGE OF
TOTAL POPULATION



45.0%

ANNUAL CHANGE
IN THE NUMBER
OF INTERNET USERS



+8.2%
+47 MILLION

AVERAGE DAILY TIME USERS
AGED 16 TO 64 SPEND
USING THE INTERNET



6H 36M

PERCENTAGE OF USERS
ACCESSING THE INTERNET
VIA MOBILE DEVICES



91.7%

Internet-Facilitated Purchases in India

JAN
2021

INTERNET-FACILITATED PURCHASES

PERCENTAGE OF INTERNET USERS AGED 16 TO 64 THAT USES OR PAYS FOR EACH KIND OF DIGITAL SERVICE EACH MONTH



INDIA

MOBILE PAYMENT
SERVICE (E.G. APPLE
PAY, SAMSUNG PAY)



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36.9%

PAID DIGITAL CONTENT*
(E.G. TV STREAMING, MUSIC
DOWNLOADS, EPUBLISHING)



GWJ.

78.7%

ONLINE RIDE-
HAILING SERVICE (E.G.
UBER, DIDI CHUXING)



25.5%

ONLINE FOOD
DELIVERY SERVICE (E.G.
DOORDASH, DELIVEROO)



58.1%



Top Global E-Commerce Companies based on Traffic – April 2021


Domain	Country	Website category	Monthly visits
allegro.pl	Poland	E-commerce and Shopping/Marketplace	197,386,460
amazon.com	USA	E-commerce and Shopping/Marketplace	2,553,407,984
apple.com	USA	Computers Electronics and Technology/Consumer Electronics	433,362,817
argos.co.uk	UK	E-commerce and Shopping/Marketplace	67,085,544
asos.com	UK	Lifestyle/Fashion and Apparel	76,083,048
bestbuy.com	USA	Computers Electronics and Technology/Consumer Electronics	149,003,135
bol.com	Netherlands	E-commerce and Shopping/Marketplace	87,220,542
chewy.com	USA	Pets and Animals/Pet Food and Supplies	50,048,399
cmoa.jp	Japan	Arts and Entertainment/Animation and Comics	76,586,719
costco.com	USA	E-commerce and Shopping/Marketplace	84,556,930
dmm.com	Japan	E-commerce and Shopping/Marketplace	57,897,643
ebay.co.uk	UK	E-commerce and Shopping/Marketplace	337,941,703
etsy.com	USA	E-commerce and Shopping/Marketplace	405,641,946
flipkart.com	India	E-commerce and Shopping/Marketplace	171,346,114

Category-wise E-Commerce Growth in India

JAN
2021

ECOMMERCE GROWTH BY CATEGORY

YEAR-ON-YEAR CHANGE IN THE TOTAL AMOUNT SPENT IN CONSUMER ECOMMERCE CATEGORIES IN 2020 vs. 2019

 CHANGES TO CATEGORY DEFINITIONS AND REVISIONS TO HISTORICAL DATA MEAN VALUES ARE NOT COMPARABLE WITH PREVIOUS REPORTS



INDIA

TRAVEL, MOBILITY, &
ACCOMMODATION*



-54.4%

statista

FASHION
& BEAUTY



+39.5%



ELECTRONICS &
PHYSICAL MEDIA



+32.1%

we
are
social

FOOD &
PERSONAL CARE



+55.4%

FURNITURE &
APPLIANCES



+29.9%



TOYS, DIY
& HOBBIES



+29.6%

we
are
social

DIGITAL
MUSIC



+45.2%

statista

VIDEO
GAMES



+50.1%

75

SOURCES: STATISTA MARKET OUTLOOKS FOR E-COMMERCE, TRAVEL, MOBILITY, AND DIGITAL MEDIA (ACCESSED JAN. 2021). FIGURES BASED ON COMPARISONS OF ESTIMATES OF FULL-YEAR ONLINE CONSUMER SPEND IN 2020 AND 2019, EXCLUDING B2B SPEND. SEE [STATISTA.COM/OUTLOOK/DIGITAL-MARKETS](https://www.statista.com/outlook/digital-markets) FOR MORE DETAILS. **NOTES:** DATA FOR DIGITAL MUSIC AND VIDEO GAMES INCLUDE STREAMING. **COMPARABILITY ADVISORY:** SOME BASE CHANGES. DATA MAY NOT BE DIRECTLY COMPARABLE WITH FIGURES PUBLISHED IN PREVIOUS REPORTS.

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Background – Action 1 of the OECD BEPS project

- ❑ Digital economy has led to new business models that rely more on digital & telecommunication network, do not require physical presence, & derive substantial value from data collected & transmitted from such networks
- ❑ Genesis of EL is in Action 1 – Addressing the Tax Challenges of the Digital Economy, of the OECD BEPS project
- ❑ Action 1 addresses the following concerns:
 - Tax planning by MNE to artificially reduce taxable income or shift profits to low tax jurisdictions in which little or no economic activity is performed
 - Lack of coherence of international tax rules with the new digital business model with heavy reliance on intangibles
- ❑ Action 1 discussed the following three options:
 - New nexus based on SEP
 - Withholding tax on certain types of digital transactions
 - EL

Background – Committee on Taxation of E-Commerce

- ❑ Action 1 report was accepted by the G20 countries, following which CBDT constituted a Committee for examining tax issues of new business models in the digital economy

- ❑ The Committee submitted its report on Taxation of E-Commerce in February 2016, key observations being:
 - Issues arising due to unfair advantage enjoyed by MNE over their Indian competitors, required immediate attention

 - Of the 3 options discussed in Action Plan 1, EL is the most feasible as the other options cannot be implemented unilaterally due to DTAA obligations

 - Not being a tax on income, EL would have to be imposed outside the IT Act, 1961 & would not be covered by DTAA

 - EL may be charged at a rate between 6% to 8% of the gross sum for specified services

 - Suggested exemption of Rs. 1 lakh will exclude most B2C & several B2B transactions

 - Payments subjected to EL to be exempted from income-tax

 - Disallowance of expense if EL has not been deducted

 - Reporting & compliance obligations to be kept simple

Some Judicial precedents prior to EL

- ❑ **Pinstorm Technologies Pvt. Ltd. (2012) 54 SOT 78 (Mum ITAT) – Online Advertising**
Payment for uploading & display of banner advertisement on NR's portal not taxable as No PE
- ❑ **Right Florists (Pvt.) Ltd. (2013) 154 TTJ 142 (Kol ITAT) – Online Advertising**
 - Unless web servers were located in India, there can be No PE for search engines through websites
 - Payment to foreign search engine portals for online advertising services not FTS, Business profits not taxable as No PE
- ❑ **eBay International AG (2013) 140 ITD 20 (Mum ITAT) – Online Shopping**
Revenue arising from operating websites for facilitating the purchase & sale of goods & services to users based in India, not FTS, Business profits not taxable as No PE
- ❑ **Amadeus Global Travel Distribution SA (2008) 113 TTJ 767 (Del ITAT) – Computerised Reservation System**
Revenue arising from maintaining & operating a CRS through which the subscribing travel agents offered ticketing & reservation services to Indian clients, was taxable as the computer hardware/ software provided to the travel agents, constituted a PE in India
- ❑ **People Interactive (India) Pvt Ltd ITA No.2182/Mum/2009 (Mum ITAT) – Website Hosting**
Payment for website hosting not royalty as the the servers & equipment were not operated, used or under the control of the assessee, Business profits not taxable as No PE

Equalisation Levy 1.0

EL 1.0 (popularly known as Google Tax) on Online Advertising – Charge

- ❑ Enacted vide Finance Act, 2016 as a separate Chapter (Chapter VIII – sections 163 to 180) in the Finance Act, 2016
- ❑ India is the first country to introduce EL in its domestic law



Applies @ 6% on gross consideration for any 'specified service' payable to an NR by a payer who is either a resident carrying on business/profession or a PE of an NR – **section 165(1)**

"specified service" means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement & includes any other service as may be notified – **section 164(i)**

"online" means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network – **section 164(f)**



Section 10(50) – Income chargeable to EL 1.0, is exempted from income-tax

Section 40(a)(ib) - Disallowance of consideration paid/payable for a specified service on which EL is deductible & such levy has not been deducted or after deduction, has not been paid on or before the due date u/s 139(1). If paid after the said due date, expense allowed in year of payment of EL



Section 165(2) - Levy not applicable if:

- NR service provider has an Indian PE to which the 'specified service' is effectively connected
- Aggregate consideration in a year does not exceed Rs. 1 lakh
- Payment for specified service by the resident payer or the Indian PE, is not for the purposes of carrying out business/ profession

EL 1.0 (popularly known as Google Tax) on Online Advertising – Collection & Recovery

❑ Section 166(1):

Every person, being a resident & carrying on business or profession or NR having a PE in India (referred to as assessee), **shall deduct EL 1.0 from the amount paid or payable** to NR in respect of the specified service

❑ Section 166(2):

EL 1.0 so deducted during any calendar month shall be paid to the credit of the Central Government **by the 7th day of the following month**

❑ Section 166(3):

Any assessee **who fails to deduct** EL 1.0 as provided shall, notwithstanding such failure, **be liable to pay** the levy to the credit of the Central Government

Equalisation Levy 2.0

EL 2.0 on E-Commerce Supply or Services – Charge

- ❑ Levy was not proposed in the original Finance Bill, 2020; Was introduced as an amendment tabled before the Lok Sabha which was **enacted vide the Finance Act, 2020** after President’s assent to the amended Finance Bill

Applicability – section 165A(1)	On and from 1 April 2020, on consideration received/ receivable from specified payers by NR e-commerce operator who is engaged in e-commerce supply or services made or provided or facilitated by it
Person responsible for paying EL 2.0 – section 165A	NR e-commerce operator
Definition of e-commerce operator – section 164(ca)	Means an NR who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both
Definition of e-commerce supply or services – section 164(cb)	<ul style="list-style-type: none">• Online sale of goods owned by the e-commerce operator• Online provision of services provided by the e-commerce operator• Online sale of goods or provision of services or both facilitated by the e-commerce operator• Any combination of the above activities
Specified payers – section 165A(1)	<ul style="list-style-type: none">• A person resident in India; or• An NR in ‘specified circumstances’• A person who buys such goods or services or both using IP address located in India

EL 2.0 on E-Commerce Supply or Services – Charge

(Contd..)

Specified circumstances – section 165A(3)	<ul style="list-style-type: none">• Sale of advertisement targeting a customer, who is resident in India or accesses the advertisement through an IP address located in India• Sale of data collected from customer, who is resident in India or from a person using an IP address located in India
Rate of EL 2.0 – section 165A(1)	2% of the consideration received / receivable by the e-commerce operator
Exclusions – section 165A(2)	<ul style="list-style-type: none">• NR e-commerce operator having PE in India with which the e-commerce supply/ service is effectively connected• Cases where EL 1.0 is already leviable i.e., on online advertising and related activities• Cases where sales, turnover or gross receipts of the NR e-commerce operators from e-commerce or services, is less than Rs. 2 crore during the financial year
Exemption from income-tax – section 10(50)	<ul style="list-style-type: none">• Consequential income-tax exemption for income subjected to EL on or after 1 April 2021 – <i>should have been 1 April 2020, this timing anomaly rectified later by Finance Act, 2021</i>

Amendments made to EL 2.0 by the Finance Act, 2021

- ❑ **Proviso inserted in section 163(3)** stating that the consideration received/ receivable for specified services & for e-commerce supply or services shall not include the consideration which is taxable as royalty/FTS under the IT Act read with DTAA

- ❑ **Explanation inserted to clause (cb) of section 164** stating that “online sale of goods” & “online provision of services” shall include one or more of the following activities:
 - (a) acceptance of offer for sale; or
 - (b) placing of purchase order; or
 - (c) acceptance of purchase order; or
 - (d) payment of consideration; or
 - (e) supply of goods or provision of services, partly or wholly

- ❑ **Clause (b) inserted in section 165A(3)** providing that consideration received/ receivable from e-commerce supply or services shall include:
 - Consideration for sale of goods irrespective of whether the e-commerce operator owns the goods, excluding however, consideration for sale of goods which are owned by an Indian resident or by an Indian PE of NR, if such sale is effectively connected with such Indian PE
 - Consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator, excluding however consideration for provision of services by an Indian resident or by an Indian PE of NR, if provision of such services is effectively connected with such Indian PE

Amendments made to EL 2.0 by the Finance Act, 2021

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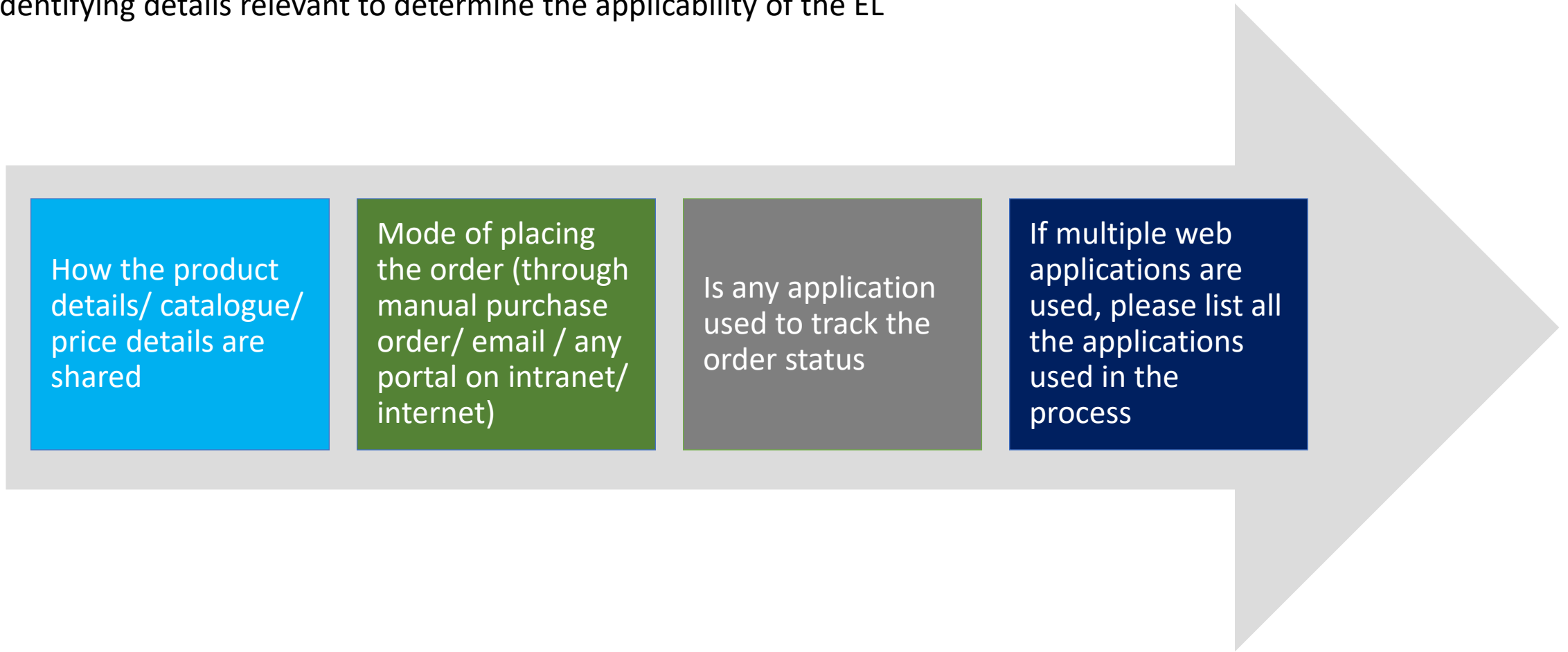
- ❑ Amendments to **section 10(50)**:
 - The exemption will not apply to consideration, which is taxable as a royalty or FTS under the IT Act read with DTAA
 - The exemption will apply from 1 April 2020 in respect of income arising from e-commerce supply or services

Entities likely to be impacted – Illustrative list

- Foreign market-places
- Foreign market aggregators
- Foreign vendors exporting goods to India – whether physical goods/ services or digital goods and services
- Foreign payment gateways
- Foreign players selling advertisements/ data collected from India to other NR (provided these payments are not taxable as royalties/FTS)
- Foreign app stores or app in apps
- Intra group intranets/ ERP/ shared services
- Foreign educational institutions conducting online classes
- Foreign OTT streaming platforms
- Foreign gaming platforms

Impact Analysis

It would be important to identify the various streams of income earned by the NR entity from India along with identifying details relevant to determine the applicability of the EL



Above exercise will help identify exposures, if any & will also provide clarity on the transactions

Issues



Meaning of 'digital or electronic facility or platform' – whether includes one-to-one communication via telephone, emails, text messages ?



Would a Request For Proposal (RFP) be covered in the ambit of 2% EL?



Whether EL applies on the gross amount of consideration or the commission/ service fee of the e-commerce operator?



Cascading effect or multiplicity of the levy when there are multiple e-commerce operators in the supply chain



Bringing 'payment of consideration' within the scope of EL, contradicts the Government's usual stance of encouraging digital payments



Applicability of EL on sales returns?



Applicability of EL on intra-group transactions?



Would indirect taxes be included in the gross consideration while applying EL?



Payments taxable as royalty/FTS & possibility to claim FTC vis-à-vis EL as a cost



Seeking refund of EL paid when the consideration is later held to be taxable as royalty/ FTS in appeal & the time to revise EL returns has lapsed

Miscellaneous

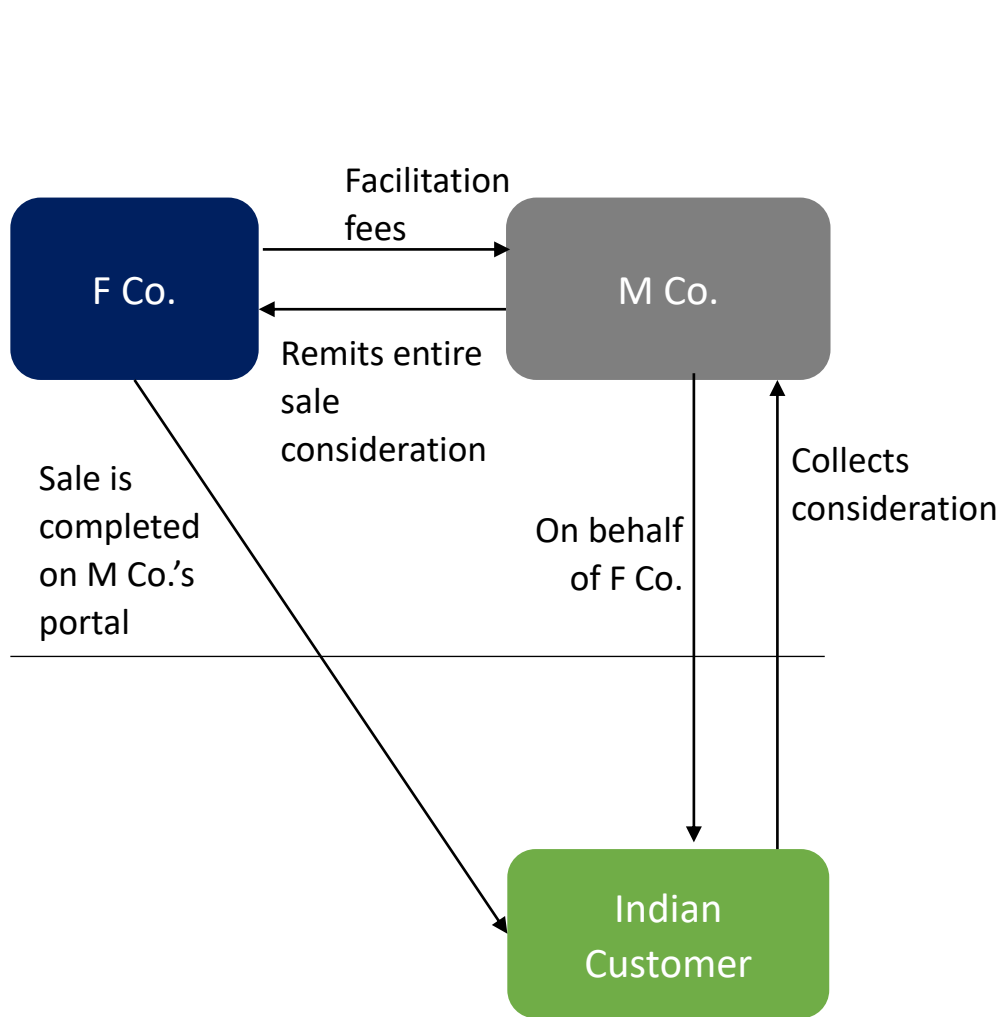
- ❑ As EL is not part of the IT Act, DTAA benefits & correspondingly FTC may not be available in the home country
- ❑ Section 174 of the Finance Act, 2016 provides for appeal before CIT(A) only against an order imposing penalty; No right of appeal against the base intimation u/s 168 determining the EL quantum – Writ may be the only remedy in such case

India's response to USTR Investigation u/s 301 of the US Trade Act on EL 2.0

- ❑ In June 2020, the USTR initiated an investigation of India's EL 2.0 u/s 301 of the Trade Act of 1974 to determine whether India's EL 2.0 is unreasonable / discriminatory & burdens / restricts U.S. commerce
- ❑ Indian Government responded as follows:
 - EL 2.0 does not discriminate against NR e-commerce operators; The purpose is to ensure a level-playing field for resident & NR e-commerce operators
 - India's EL is a consequence of its understanding of the OECD BEPS report on Action 1
 - An equally important objective is to provide greater clarity, certainty & predictability in respect of characterization of payments for digital services & consequent tax liabilities, so as to minimize tax disputes & compliance costs
 - EL 2.0 has prospective application
 - The US SC held in South Dakota vs Way fair Inc that physical presence is not required for the levy of sales tax by a state where the online seller has no physical presence but makes online sales to buyers of the state; Delhi HC decision in non-tax disputes holding that availability of transactions through the website at a particular place is virtually the same thing as a seller having shops in that place in the physical world, clearly resonates with the US SC ruling
- ❑ USTR has threatened retaliatory tariffs

Case Studies

Case Study 1 – Online market-place hosting foreign vendors selling goods to Indian customers



Mechanics

- Market place 'M Co.' lists foreign vendor 'F Co.' on its portal for a fee of USD 10
- F Co. makes an online sale of goods owned by it to an Indian customer, for say USD 100 on M Co.'s portal itself
- M Co. collects the payment on behalf of F Co. & remits to F Co. the entire consideration of USD 100
- F Co. in turn pays M Co. a facilitation fee of USD 10

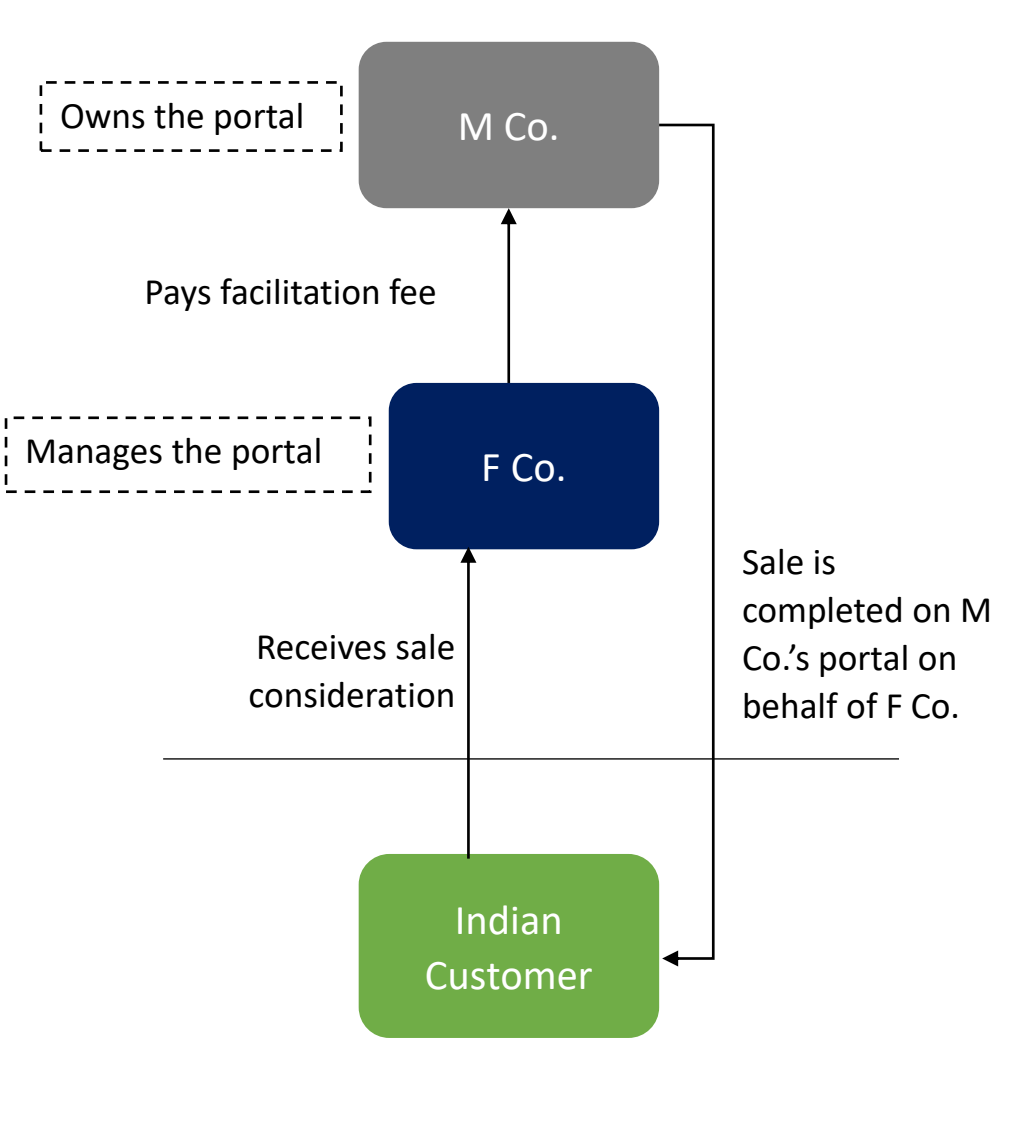
Assumptions

- F Co. does not have a PE in India within the meaning of the term 'PE' as per IT Act, 1961
- F Co. does not own, operate or manage a digital platform & is selling goods on M Co.'s portal

Issues

- Is F Co. liable to pay EL?
- Is M Co. liable to pay EL and if so on what amount?

Case Study 2 – Portal is owned by a person but operated & managed by another person



Mechanics

- M Co. owns the portal & provides facilitation service
- F Co. is a vendor who operates & manages the portal & makes online sale of goods
- F Co. receives entire consideration of USD 100 from Indian customers for online sale of goods owned by it or online provision of services
- F Co. in turn pays M Co. a facilitation fee of USD 10

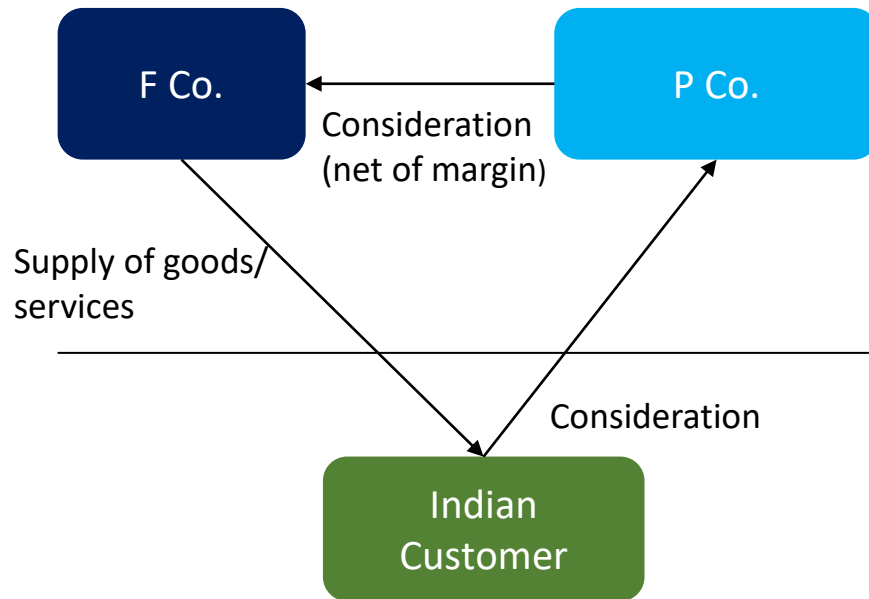
Assumptions

- M Co. & F Co. do not have PE in India within the meaning of the term 'PE' as per IT Act, 1961

Issues

- Is F Co. liable to pay EL?
- Is M Co. liable to pay EL and if so on what amount?

Case Study 3 – F Co. undertakes online sale of goods and appoints a payment gateway for collections



Mechanics

- F Co. owns a web portal on which customers can place an order
- P Co. is a payment gateway & collects consideration of USD 100 for F Co.'s goods sold to Indian customers
- P Co. owns a web portal for collections from Indian customers
- P Co. remits the net consideration to F Co. after retaining facilitation fee of USD 10

Assumptions

- F Co/ P Co. do not have PE in India within the meaning of the term 'PE' as per IT, 1961

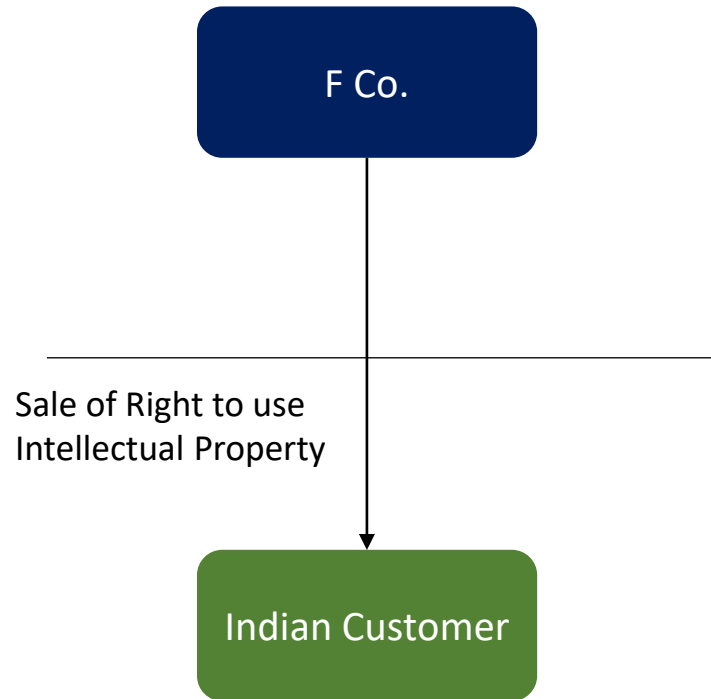
Issues

Is F Co. liable to pay EL?

Is P Co. liable to EL ?

Is P Co. liable to EL and if so on what amount?

Case Study 4 – F Co. sells right to use Intellectual Property to Indian customers under various scenarios



Mechanics

- F Co. sells right to use Intellectual Property to Indian customers through its portal

Issues

- Is F Co. liable to pay EL under various scenarios outlined in the following slides?

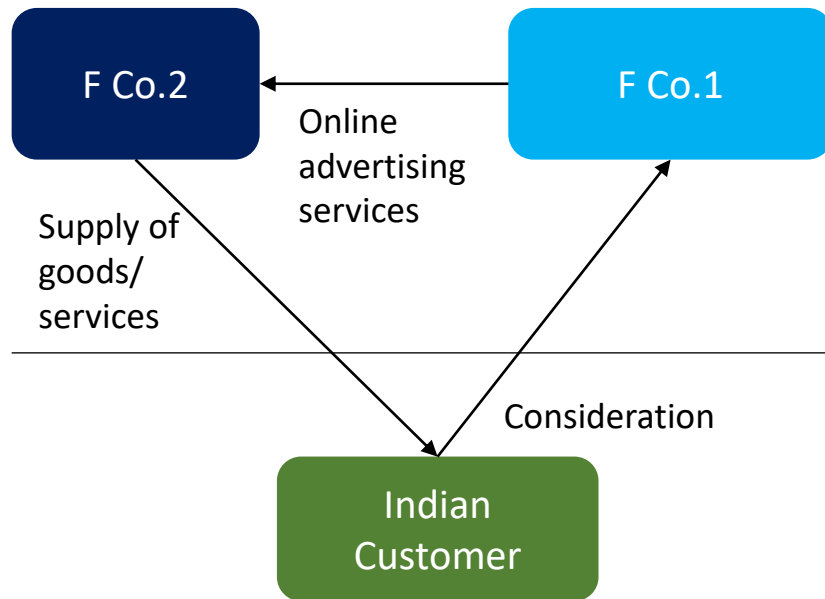
Case Study 4 – Various scenarios (1/2)

Sr. No.	Scenarios	Royalty/FTS under Act	Royalty/FTS under DTAA	Fixed PE under the Act and DTAA	Will EL apply?
1	Payment is royalty/FTS under the Act but not covered because of second source rule i.e., NR to NR payment where payer does not use the service for its business in India	No	N.A.	No	Yes
2A	Payment is royalty/FTS under the Act but exempt under DTAA on account of e.g.: (i) Narrower DTAA definition for royalties/FTS (ii) Make available clause for FTS (iii) Exclusions from definition	Yes	No	No	Yes
2B	Same as above except that there is a Fixed place PE in India	Yes	No	Yes	No

Case Study 4 – Various scenarios (2/2)

Sr. No.	Scenarios	Royalty/FTS under Act	Royalty/FTS under DTAA	Fixed PE under the Act and DTAA	Will EL apply?
3A	Payment is royalty/FTS under the Act and DTAA	Yes	Yes	No	No
3B	Same as above except that there is a Fixed place PE in India	Yes	Yes	Yes	No

Case Study 5 – Online advertising services



Mechanics

- F Co.1 owns a web portal/ search engine on which F Co. 2 advertises its goods
- F Co. 2 owns a portal and sells goods online to Indian customers

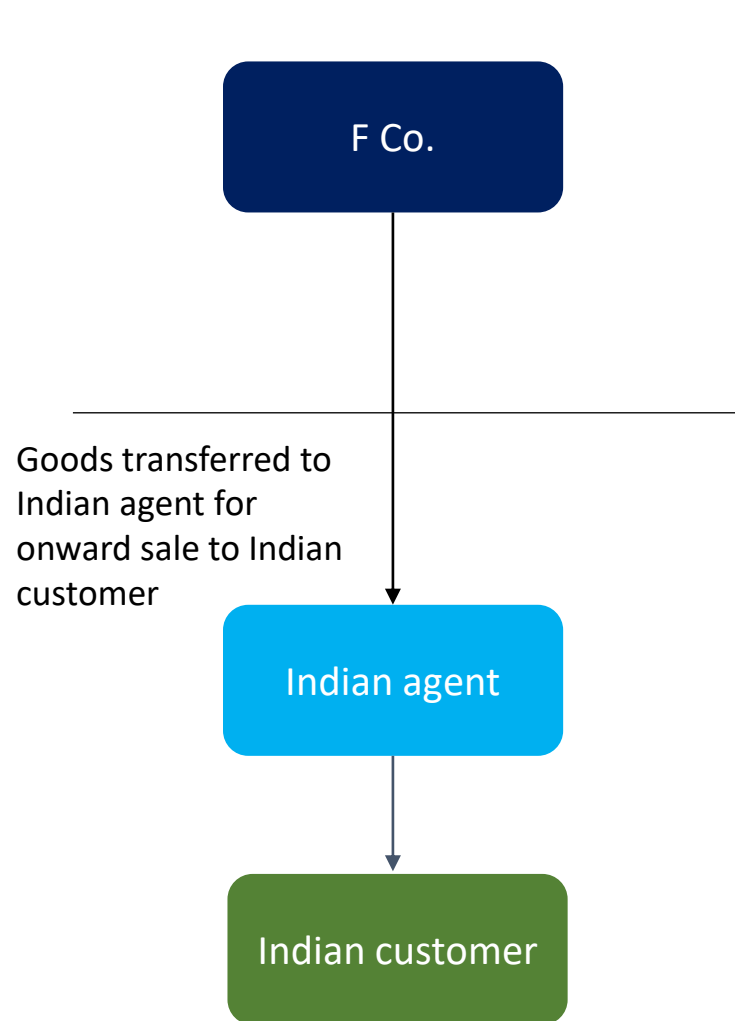
Assumptions

- F Co.1/ F Co. 2 do not have PE in India within the meaning of the term 'PE' as per IT Act, 1961.

Issues

- Is F Co.1 liable to pay 6% EL?
- Is F Co. 1 liable to pay 2% EL?
- Is F Co. 2 liable to 2% EL?

Case Study 6 – F Co. has an agency PE in India



Mechanics

- F Co. sells goods to Indian customers through its portal
- Goods are delivered physically through agent in India. Agent creates F Co.'s agency PE in India

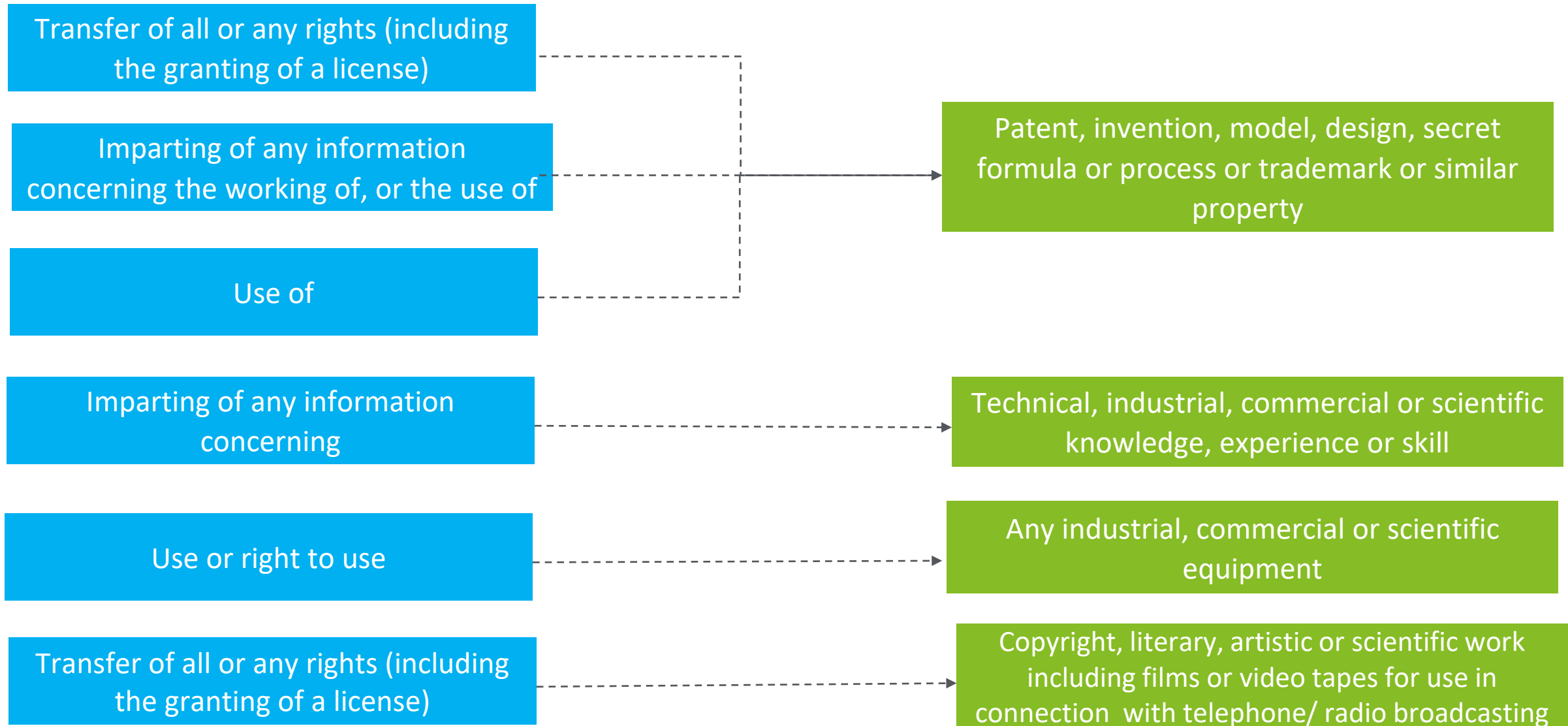
Issues

- Is F Co. liable to pay EL?

Royalty

Definition under the IT Act

Explanation 2 to section 9(1)(vi): Consideration (including lumpsum consideration) for:



Definition under the IT Act

Contd..

- ❑ Royalty also **includes** consideration for the rendering of any services in connection with the aforementioned activities

- ❑ Royalty **excludes**:
 - Capital Gains
 - Amounts referred to in section 44BB
 - Consideration paid under certain Government approved schemes/ agreements
 - Consideration for the sale, distribution or exhibition of cinematographic films – exclusion removed by the Finance Act, 2020 w.e.f. 1 April 2021

Explanations 4, 5, 6 inserted by the Finance Act, 2012 w.r.e.f. 1 April 1976

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

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

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 fiber or by any other similar technology, whether or not such process is secret

"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

Royalty Definition

OECD Model	UN Model
Use of, or the right to use: <ul style="list-style-type: none">any copyright of literary, artistic or scientific work including cinematograph films	Use of, or the right to use: <ul style="list-style-type: none">any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting
Use of, or the right to use: <ul style="list-style-type: none">any patent, trademark, design or model, plan, secret formula or process	Use of, or the right to use: <ul style="list-style-type: none">any patent, trademark, design or model, plan, secret formula or processindustrial, commercial or scientific equipment
For information concerning industrial, commercial or scientific experience	For information concerning industrial, commercial or scientific experience

Royalty under OECD model is narrower as compared to UN model

Supreme Court ruling on characterization of software payments
Engineering Analysis Centre of Excellence (P) Ltd [2021] 125 taxmann.com 42 (SC)

Background

Issues dealt with by Hon'ble SC



- Computer software was brought within the ambit of 'royalty' definition in 1991 (Copyright Act, 1957 recognized computer software in 1994)
- Litigation on characterization of payments for purchase of shrink-wrapped software/off the shelf software started in late 1990s (Department view - 'royalty' vs taxpayer's view – goods)
- The matter reached the Apex Court for the first time in 2010 when the SC held that payer need not approach tax authority for every payment and can make a determination on his own and remanded the case back to Karnataka HC (KHC) to decide on merits
- SC has now decided on the divergent rulings of various courts, primarily, the judgments of the KHC- against taxpayer, the Delhi HC (DHC) – in favour of taxpayer and the mixed Rulings of AAR

Facts of the appeals covered

- The SC judgement covers 86 appeals, broadly grouped into four categories –

Category 1	Cases where computer software is purchased directly by resident end-user from NR supplier or manufacturer
Category 2	Cases where resident Indian companies act as distributors or resellers, by purchasing computer software from NR suppliers or manufacturers & then resell the same to resident Indian end-users
Category 3	Cases where the NR distributor or vendor purchases the software from NR seller & resells the same to resident Indian distributors or end-users
Category 4	Cases where computer software is affixed onto hardware & is sold as an integrated unit/ equipment by NR supplier to resident Indian distributors or end-users

SC ruling

On scheme of the IT Act, 1961:

- ❑ On analysis of sections 2(7), 2(37A), 4, 5, 9, 90, 195, & 201, highlights that transactions involving transfer of all or any rights, specifically, granting of a licence, in respect of any copyright in a literary work is governed by DTAA as recognized by section 5(2) rws 90 & that the machinery provision in section 195 is inextricably linked with the charging provision contained in section 9 rws 4
- ❑ Clarifies that a person resident in India, responsible for paying a sum of money to an NR is liable to deduct tax only if the NR is liable to pay tax under the charging provision contained in section 9 rws 4 along with the DTAA. Further section 201 would make a resident-payee 'assessee in default' only if NR is liable to pay income tax in India
- ❑ Relies on SC ruling in Azadi Bachao Andolan to hold that once a DTAA applies, the provisions of the Act can only apply to the extent that they are more beneficial to the assessee & not otherwise. Parliament has clarified that where any term is defined in a DTAA, the definition contained in the DTAA is to be looked at. It is only where there is no such definition that the definition in the Act can then be applied

Contd..

SC ruling

On scheme of the IT Act, 1961:

Contd..

- ❑ Factually distinguishes SC ruling in **PILCOM** in the context of deduction u/s 194E on payments made to NR sportsperson/ association & observes that section 194E deals with TDS without reference to chargeability under the Act of the concerned NR. Relies on SC ruling in **GE Technology**, where it was held that at the heart of section 195 is the fact that deductions can only be made if the NR assessee is liable to pay tax under the provisions of Act in the first place. Holds that the PILCOM ruling has no application to the facts of the case

Interpretation of the provisions of Copyright Act, 1957

- ❑ Examines provisions of sections 2(a), 2(d), 2(fa), 2(ffb), 2(ffc), 2(m), 2(o) 14, 16, 18, 19, 30, 30A, 51, 52, 58 of the Copyrights Act & holds:
 - the creator (author) of literary work inclusive of computer program has the exclusive right to do or authorise the doing of several acts in respect of such work
 - the right to reproduce a computer programme and exploit the reproduction by way of sale, transfer, license etc. is at the heart of the said exclusive right
 - on assignment of rights contained in section 14(a) and (b) of the Copyrights Act by the owner, the assignee will be treated as the owner of the copyright of what is assigned to him

Contd..

SC ruling

Interpretation of the provisions of Copyright Act, 1957

Contd..

- interest in copyright may be granted by owner u/s 30 of Copyrights Act by way of license in writing, entitling royalty payment
 - copyright is infringed when any use, relating to the said interest/right that is licensed, is contrary to the conditions of the licence so granted
 - what is referred to in section 52(1)(aa) of Copyright Act i.e., making of copies, or adaptation of a computer programme for use etc., would not amount to infringement, and
 - section 52(1)(ad) provides that making copies from personally legally obtained copy for non-commercial does not amount to infringement
- ❑ section 52(1)(ad) of the Copyright Act (makes exploitation of personally legally obtained copy for commercial use, an infringement of copyright) cannot be read to negate the effect of section 52(1)(aa)

SC ruling

On End User License Agreements (EULA)/ Distributor Agreements

- ❑ Certain terms in the distributor agreements like 'no copyright in the computer programme is transferred either to the distributor or to the ultimate end-user' & 'no further right to sub-license or transfer, nor is there any right to reverse-engineer, modify, reproduce in any manner otherwise than permitted by the licence to the end-user', clarify that only a non-exclusive, non-transferable licence to resell computer software. Consideration paid by distributor is the price of computer programmes as goods either in a medium which stores the software or in a medium by which software is embedded in hardware for onward resale & distributor gets no right to use the product
- ❑ As per EULA, end-user can only use it by installing it in the computer hardware owned by the end-user & cannot in any manner reproduce the same for sale or transfer, remarks that license transferred is not a license u/s 30 of Copyrights Act, but a license which imposes restrictions or conditions for the use of computer software
- ❑ Relies on SC ruling in **State Bank of India v Collector of Customs** to distinguish between the reproduction of software & the use of software & holds that the former would amount to parting of copyright by the owner, but the latter would not
- ❑ Follows the Constitution Bench judgment in **Tata Consultancy Services** to hold that the licence granted by the NR supplier either to the distributor or the end user is the sale of a physical object embedded with a computer programme

SC ruling

On the provisions of the DTAA

- ❑ All the DTAA's involved in the current case are based on OECD Model Convention & are similar. Examines India-Singapore DTAA and refers to CBDT Circular No. 333 dated 2 April, 1982 to clarify that the expression "royalty", when occurring in section 9 of the Act, has to be construed with reference to Article 12 of the DTAA. Holds that royalties are payments of any kind received as consideration for "the use of, or the right to use, any copyright" of a literary work, which includes a computer programme or software
- ❑ On application of DTAA provisions (on account of Article 30 of India-USA DTAA) to TDS u/s 195, rejects Revenue's contention that section 195 deals with deduction made prior to assessment to tax, not being in the nature of tax & a stage prior to declaring a person as 'assessee in default'. Refers to SC ruling in **GE Technology** & clarifies that a deduction is to be made u/s 195 only if tax is payable by NR assessee, holds that charging & machinery provisions u/ss 9 & 195 are interlinked

Contd..

SC ruling

On the provisions of the DTAA

Contd..

- ❑ Revenue's contention that DTAA is inapplicable while discharging TDS liability u/s 195, would lead to much higher deduction u/s 195 than the respective DTAA rate which would result in a disproportionate deduction of tax by the resident as compared to the rates applicable to the NR

On definition of Royalty in DTAA vis-à-vis the Act

- ❑ The expression 'royalty' under Explanation 2 to section 9(1)(vi) is wider than the expression contained in India-Singapore DTAA in the following aspects:
 - it also includes lump sum consideration not chargeable under capital gains
 - 'all or any rights' includes transfer of license
 - includes that term transfer 'in respect of' of any copyright of any literary work
- ❑ Transfer of 'all or any rights in respect of' u/s 9(1)(vi) corresponds to sections 14(a), 14(b), 30 of the Copyright Act & is more expansive than DTAA provision which reads 'use of, or the right to use' any copyright
- ❑ Explanation 4 to section 9(1)(v) is not clarificatory of the position of the law as it stood since 1976 as:
 - Explanation 3 refers to computer software for the first time w.e.f. 1991 & Explanation 4 cannot apply to any right for the use of or the right to use computer software even before the term "computer software" was inserted in the statute
 - section 2(o) of the Copyright Act, the term "computer software" was introduced for the first time in the definition of a literary work & defined under section 2(ffc) only in 1994

Contd..

SC ruling

On definition of Royalty in DTAA vis-à-vis the Act

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- ❑ On application of TDS provisions prior to insertion of Explanation 4 on the presumption that Explanation 4 always existed in the statute, SC relies upon two latin maxims - *lex non cogit ad impossibilia* ie. the law does not demand the impossible & *impotentia excusat legem* ie. when there is a disability that makes it impossible to obey the law, the alleged disobedience of the law is excused. Relies on SC ruling in **Arjun Panditrao Khotkar v Kailash Kushanrao Gorantyal**, where on the basis of the aforementioned legal maxims, respondent was relieved of the mandatory obligation to furnish certificate under the Evidence Act, 1872, after failing to obtain it despite several efforts
- ❑ Refers to Bombay HC ruling in **NGC Networks (India)** in the context of Explanation 6 to section 9(1)(vi) introduced in 2012 w.r.e.f. 1976 & **Western Coalfields** in the context of retrospective amendment to section 17(2)(ii) to highlight the impossibility of discharging TDS obligation. Holds that person mentioned in section 195 cannot be expected to do the impossible, namely to apply the expanded definition of “royalty” inserted by Explanation 4 to section 9(1)(vi) for AYs in question

On various AAR rulings and HC judgments

- ❑ Upholds the rationale behind AAR rulings in **Dassault Systems & Geoquest Systems** whereas held that **Citrix Systems** did not state the law correctly. On first principles, the extract from Copinger & Skone James on Copyright (14th Edition) (1999) referred to in Dassault Systems made it clear that the ownership of copyright in a work is different from the ownership of the physical material in which the copyrighted work may be embedded which got completely missed out in **Citrix Systems**
- Contd..**

SC ruling

On OECD Commentary

Contd..

- ❑ When the definition of “royalties” is seen in all the DTAA’s that we are concerned with, it is found that “royalties” is defined in a manner either identical with or similar to the definition contained in Article 12 of the OECD Model Tax Convention. This being the case, the OECD Commentary on the provisions of the OECD Model Tax Convention then becomes relevant
- ❑ As regards India’s position w.r.t. OECD commentary ‘reserving its right’ to tax royalties, SC opines, “It is significant to note that after India took such positions qua the OECD Commentary, no bilateral amendment was made by India & the other Contracting States to change the definition of royalties contained in any of the DTAA’s that we are concerned with in these appeals, in accordance with its position.” Also refers to Delhi HC ruling in **New Skies Satellite BV** where it was held that mere taking of positions with respect to the OECD Commentary would not alter the DTAA’s provisions, unless they are actually amended by a bilateral re-negotiation. Thus, SC states that the OECD Commentary on Article 12 of the OECD Model Tax Convention, incorporated in the DTAA’s, will continue to have persuasive value as to the interpretation of the term “royalties” contained therein

Contd..

SC ruling

On OECD Commentary

Contd..

- ❑ Rejects Revenue's reliance on the E-Commerce Report 2016 that proposed EL on specified digital services & also recommended that withholding tax on digital transactions would require an express inclusion in DTAA in order to be feasible. SC points out that these reports do not carry the matter much further as they are recommendatory reports expressing the views of the committee members, which the Government of India may accept or reject. SC elucidates that even if the position put forth in the aforementioned reports were to be accepted, a DTAA would have to be bilaterally amended before any such recommendation can become law in force for the purposes of the Act

- ❑ As regards reliance placed by the Revenue on SC ruling in **Commissioner of Customs v. G.M. Exports**, where four propositions were culled out in the context of the levy of an anti-dumping duty in consonance with the General Agreement on Tariffs and Trade (GATT), 1994, SC states that the conclusions drawn in the aforesaid case have “no direct relevance to the facts at hand as the effect of section 90(2) of the IT Act, read with Explanation 4 thereof...”

- ❑ Also refers to CBDT Circular No. 10/2002 dated 9 Oct, 2002 whereby CBDT, after referring to Sec.195 had itself made a distinction between remittances for royalties & remittances for supply of articles or computer software in the proforma of the certificate to be issued as per the Circular. Opines “This is one more circumstance to show that the Revenue has itself appreciated the difference between the payment of royalty & the supply/use of computer software in the form of goods, which is then treated as business income of the assessee taxable in India if it has a PE in India”

Key Takeaways

- ❑ At the stage of TDS u/s 195, effect of DTAA shall be taken into account by the deductor
- ❑ The computer software & the licence that is granted by EULA, is not a 'licence' that transfers an interest in all or any of the copyright rights, but is a 'licence' that imposes restrictions or conditions on the use of computer software
- ❑ What is "licensed" by the foreign, NR supplier to the distributor & resold to the resident end-user, or directly supplied to the resident end-user, is in fact the sale of a physical object which contains an embedded computer programme, & is therefore, a sale of goods; Distinction between Copyrighted article & Copyright upheld
- ❑ Explanation 2(v) to Sec. 9(1)(vi), on 'all of any rights...in respect of copyright' is certainly more expansive than the DTAA provision which has 'use of, or the right to use' any copyright; applying the 'doctrine of impossibility, the payer cannot be expected to do the impossible u/s 195 i.e., to apply the expanded definition of 'royalty' inserted by Explanation 4 to Sec. 9(1)(vi) for the AYs when the said Explanation was not actually & factually in the statute
- ❑ The OECD Commentary will continue to have persuasive value for interpretation of the term 'royalties
- ❑ Amount paid by resident Indian end users/ distributors to NR computer software manufacturers/ suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not payment of royalty for the use of copyright in the computer software & that the same does not give rise to any income taxable in India, as a result of which TDS u/s 195 of the Act, was not applicable

Applicability of EL & SEP

- As the SC has held that software payments are not in the nature of royalty, exemption may not be available & the said transactions would have to be examined for applicability of EL
- Also, if TDS has been done in the past & the NR has been able to claim full FTC, going forward, one may have to evaluate if continuing to do TDS & claiming FTC is more beneficial or the EL - Can a claim by the taxpayer that software receipts are royalty be sufficient compliance to claim exemption from EL?
- Overlap of EL with SEP provisions which apply from AY 2022-23

Appendix

Significant Economic Presence u/s 9(1)(i) - Finance Act, 2018 read with Finance Act, 2020

- ❑ Finance Act, 2018 inserted Explanation 2A to section 9(1)(i) clarifying that SEP of an NR in India will constitute a "business connection" in India & defining SEP to include certain transactions & activities beyond prescribed thresholds
- ❑ Finance Act, 2020 amended Explanation 2A & provided that SEP shall cover:
 - Transactions in respect of any goods, services, or property carried out by an NR in India including provision of download of data or software in India provided the annual revenue therefrom exceeds prescribed monetary threshold – **Rs. 2 crore (CBDT Notification No 41/2021 dt 3 May 2021)**; or
 - Systematic & continuous soliciting of business activities or engaging in interaction with prescribed number of users in India through digital means - **3 lakh users (CBDT Notification No 41/2021 dt 3 May 2021)**
- ❑ Above transactions or activities will constitute SEP irrespective of whether:
 - The agreement for such transactions or activities is entered in India; or
 - The NR has a residence or place of business in India; or
 - The NR renders services in India
- ❑ Only so much as is attributable to the specified transactions & activities, shall be deemed to accrue or arise in India

Significant Economic Presence u/s 9(1)(i) - Finance Act, 2018 read with Finance Act, 2020

- ❑ Finance Act, 2020 has added new Explanation 3A to section 9(1)(i) to provide that income attributable to the operations carried out in India will include income from:
 - Such advertisement that targets a customer who resides in India or a customer who accesses the advertisement through IP address located in India;
 - Sale of data collected from a person who resides in India or from a person who uses IP address located in India;
 - Sale of goods or services using data collected from a person residing in India or uses IP address located in India

SEP to apply from AY
2022-23 & onwards

Threshold of
“revenue” – Rs.2 crore
“users” – 3 lakh users

Implementation of SEP
has not been deferred
further in the latest
Union Budget 2021

Interplay between EL &
SEP to be examined,
particularly for
transactions with non-
treaty countries

Abbreviations

AAR	Authority for Advance Rulings	OECD	Organisation for Economic Cooperation and Development
AY	Assessment Year	OTT	Over The Top
B2B	Business-to-Business	PE	Permanent Establishment
B2C	Business-to-Consumer	SC	Supreme Court
BEPS	Base Erosion and Profit Shifting	SEP	Significant Economic Presence
CBDT	Central Board of Direct Taxes	TDS	Tax Deducted at Source
DTAA	Double Taxation Avoidance Agreement	UK	United Kingdom
EL	Equalisation Levy	UN	United Nations
ERP	Enterprise Resource Planning	US/ USA	United States/ United States of America
FIS	Fees for Included Services	USTR	United States Trade Representative
FTC	Foreign Tax Credit	w.e.f.	With Effect From
FTS	Fees for Technical Services	w.r.e.f.	With Retrospective Effect From
HC	High Court		
IP	Internet Protocol		
IT	Income Tax		
IT Act	Income-tax Act, 1961		
MFN	Most Favored Nation		
MNE	Multi-National Enterprise		
NR	Non-Resident		

Thank You