What's New

Tax Insights

23 April 2024

Reimbursement amount received by taxpayer from its Indian AE towards cross charge of third-party software licence procured centrally for group cannot be characterised as 'royalty' – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal) in a recent ruling[1] concluded that the reimbursement amount received by a non-resident taxpayer towards cross charge of cost of third-party software procured centrally under a global agreement for all the entities within the group cannot be characterised as royalty under the India-Denmark Double Taxation Avoidance Agreement in absence of any transfer of copyright in the software. The ruling reaffirms the view laid down by the Supreme Court regarding taxability of software licence fees.

In detail

Facts

- The taxpayer is a foreign company with its registered office in Denmark. The taxpayer is a fin-tech company providing capital market platforms, tools and knowledge to its clients for investment strategies globally.
- The taxpayer did not carry on any business operation in India during the year.
- During the assessment year (AY) in consideration, the taxpayer procured various shrink-wrapped software user licences from the third-party under a global agreement for all the entities within the group and had received reimbursement of cross charges against the cost of the said software licences from its Indian associated enterprise (AE) after tax deducted at source under section 195 of the Income-tax Act, 1961 (Act).
- Such software licences are used by the group for carrying out its business operations.
- The tax authorities contended that the taxpayer is procuring the said software licences for the whole group and maintains an information technology (IT) infrastructure. Thus, the payment received was for making available its IT infrastructure on actual usage basis and is to be treated as equipment royalty.

Taxpayer's contentions

- The taxpayer contended that it procures software solely for its business operations and for its group entities,

[1] ITA No. 2010/Del/2023

and it does not maintain any IT infrastructure. It only cross-charges the cost of software to its group entities.

- The taxpayer was able to demonstrate before the Dispute Resolution Panel that most of the software procured from the third party were installed in the laptops and desktops of the end user and does not require maintenance of any IT infrastructure and server by the taxpayer. Moreover, in certain cases, the software was accessible over the cloud, which was owned and managed by the third-party only. No servers were maintained by the taxpayer, and thus, the issue of equipment royalty does not arise in its case.
- The taxpayer relied on the Supreme Court's decision in the case of Engineering Analysis[2] and contended non-taxability of the cross charge of software licence fees received in absence of transfer of any copyright in the software.

Tribunal's ruling

- The Tribunal observed that, in the taxpayer's case, the software used by the India AE does not pertain to any use or right to use of any copyright as neither the taxpayer nor its India AE can sub-license, transfer, reverse engineer, modify or reproduce the software and user licence.
- A licence conferring no proprietary interest on the licensee, does not entail parting with the copyright. Where the core of a transaction is to authorise the end user to have access to and make use of the licensed software over which the licensee has no exclusive rights, no copyright is parted with end user. Therefore, the payment received cannot be termed as 'royalty'. The fact that tax has been deducted does not automatically make the receipt taxable as 'royalty'.
- Thus, following the Supreme Court decision in the case of Engineering Analysis[2], the Tribunal concluded that the payment received by the taxpayer from its India AE for cross charge of software licence is non-taxable in India.

The takeaways

This ruling has re-affirmed the view laid down by the Supreme Court regarding non-taxability of software licence fees in absence of transfer of copyright in the software. Thus, mere licensing or sub-licensing of software should not be taxed as royalty unless copyrights in the software are also transferred. It is also interesting to see the approach adopted by the Revenue to tax the receipts as equipment royalty. In cases where the IT infrastructure and servers are also provided and maintained by the non-resident for the group, the taxability of such cross charge as equipment royalty needs to be analysed separately.

[2] Engineering Analysis Centre of Excellence Private Limited *v.* CIT & Anr. [2021] 432 ITR 471 (SC)

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