

Supreme Court ruling on taxation of software payments to non-residents

- Way forward

Introduction

The issue of taxation on software payments to non-residents has been a subject matter of extensive debate and litigation for over two decades in India. The major dispute has been whether payments made for the acquisition of off-the-shelf software is for 'copyright' or 'copyrighted article' and whether it would be subject to tax as royalty. Giving finality to this issue, the Supreme Court (SC) in a batch of appeals, recently pronounced its judgment.

It held that the amount paid by resident Indian end-users or distributors to non-resident computer software manufacturers or suppliers, as consideration for the resale/use of the computer software through end-user licence agreement (EULA)/distribution agreements, cannot be classified as 'royalty' payment made for the use of copyright in the computer software. Hence, it does not give rise to any income taxable in India and accordingly, no tax is required to be withheld at the time of making such payments to the non-residents.

Way forward

The landmark SC ruling has now settled the contentious issue of the characterisation of software payments. Given this, the ruling gives rise to immediate action-points for taxpayers.



Contract re-negotiation

Taxpayers should evaluate if the existing contracts for software payments need to be re-negotiated, especially where such cost has been built into the overall pricing.



Tax refund

Taxpayers should evaluate the possibility of obtaining refund of taxes and interest paid by them in the past.



Applicability of equalisation levy

Taxpayers would need to evaluate the applicability of equalisation levy provisions, based on their specific facts.



New taxing provisions

Companies would also need to evaluate applicability of newly introduced provisions on sale of goods relating to Tax deduction at source (TDS) and Tax collection at source (TCS).



Applicability of ruling on new-age software transactions

Taxpayers need to analyse if the SC ruling can be applied to new business model like direct downloading of software, customization of software, cloud subscription etc.



Applicability of ruling on computer database

The SC ruling is given in context of shrink-wrapped software. Taxpayers need to analyse if the principles of the ruling can be applied to the payments made for computer database as well.



Other aspects

- Impact of the ruling on software transactions where an exclusive license is given
- Degree of reliance that can be placed on OECD commentaries given that the SC has held that such commentaries should have a persuasive value.