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Payment for downloading licensed software is payment of 'royalty' subject to withholding tax

Summary – The Bangalore ITAT in a recent case of Cosmic Circuits (P.) Ltd., (the Assessee) held that payment made by assessee to non-residents for downloading their licenced software amounted to payment of royalty and, thus, assessee was liable to deduct tax at source while making said payment.

Facts

- The appellant, a private limited company had purchased Cadence Software from Cadence Design Systems Limited, Ireland and Laker Software from Silicon Canvas Inc, USA through non resident distributor namely, M/s Reliant Electronic Design Services Pvt. Ltd. based in Singapore. The payments were made to Cadence and M/s Reliant Electronic Design Services Pvt. Ltd. for downloading of licensed software.

- The Assessing Officer held that the payments made to Cadence Design Systems Limited and M/s Reliant Electronic Design Services Pvt. Ltd. were in the nature of royalty and failure to deduct tax as required under section 195 of the Act attracted liability under section 201(1) and 201(1A) of the Act. Accordingly, orders were passed under section 201(1) and 201(1A) of the Act by the Assessing Officer on 26th March, 2010 making the appellant liable for tax under section 201(1) and interest under section 201(1A) of the Act.

- Aggrieved by the orders passed by the Assessing Officer, the appellant preferred appeals before the CIT(A).

- The CIT(A) dismissed the appeals filed by the appellant by relying on the order of the Delhi ITAT in the case of *Microsoft Corpn*. v. *ADIT* (ITA Nos.1331 to 1336/Del/2008 and ITA No.1392/Del/2005) 26-10-2010 and the Ruling of Hon'ble Authority for Advanced Rulings in the case of Advance Ruling P. No. 30 of 1999, *In re*[1999] 238 ITR 296/105 Taxman 240 (AAR - New Delhi).

Held

- Before the Bangalore ITAT, the learned DR submitted that the issue in question is squarely covered by the judgement of the Hon'ble jurisdictional High Court in the case of *CIT, International Taxation* v. *Samsung Electronics Co. Ltd.* [2011] 203 Taxman 477/16 taxmann.com 141 (Kar.),. These submissions were not controverted by the AR of the assessee.

- The ITAT held that the Hon'ble jurisdictional High Court in the case of *Samsung Electronics Co. Ltd*. (*supra*) had held that the payment made to NRI for the purchase of software is liable for tax deduction under section 195 of the Act.

- It is contended that in view of the fact that what is supplied by the non-resident to the respondent in India is only a shrink wrapped software/off the-shelf software, which is not customised to suit the needs of the respondent, the said software is to be treated as goods and there is sale of the software and copy of the software. Therefore, the question of paying any royalty would not arise.

- The ITAT held that the question as to whether the payment made for import of software or supply of software by the non-resident Companies was royalty or not was not at all an issue in its case and the question was whether canned software sold by the appellants therein amounted to sale of goods under the Andhra Pradesh General Sales Tax Act. The issue in the present case is as to whether the payment would amount to royalty within the meaning of Income Tax Act and DTTA.

- The ITAT on an examination of the provisions of the Copyright Act held that the right to copyright work would also constitute exclusive right of the copyright holder and any violation of the said right would amount to infringement under Section 51 of the Act. However, if such copying of computer program is done by a lawful possessor of a copy of such computer programme, the same would not constitute Infringement of copyright and wherefore, but for the licence granted in these cases to the respondent to make copy of the software contained in shrink-wrapped/off-the-shelf software into the hard disk of the designated computer and to take a copy for backup purposes, the end user has no other right and the said taking backup would have constituted an Infringement, but, for the licence. Therefore, when licence is granted for taking copy of the software and to store it in the hard disk and to take a back up copy then it is clear that what is transferred is right to use the software, an exclusive right, which the owner of the copyright i.e., the respondent supplier owns and what is transferred is only right to use copy of the software for the internal business as per the terms and conditions of the agreement.

- Accordingly, the ITAT held that right to make a copy of the software and use it for internal business by making copy of the same and storing the same In the hard disk of the designated computer and taking back up copy would itself amount to copyright work under Section 14 (1) of the Act and licence granted to use the software by making copies (which, but for the licence granted would have constituted infringement of copyright) would tantamount to payment of 'royalty' within the meaning of Article 12(3) of the DTAA and even as per the provisions of 9(1)(vi) of the Act.