Software payments can't be held as royalty when reproduction rights are given for internal usage

Summary – The Mumbai ITAT in a recent case of Qad Europe B. V., (the Assessee) held that where assessee, a dutch-company, entered into an agreement with an Indian company for sale of licensed software, in view of fact that said agreement did not permit indian company to carry out any alteration or conversion of any nature, so as to fall within definition of 'adaptation' as defined in Copyright Act, 1957 and right given to customer for reproduction was only for limited purpose and no right was given for commercial exploitation of same, payment made by indian company cannot be construed as payment made towards 'use' of copyright and hence, could not be taxed as 'Royalty'

Facts

- The assessee, viz. Qad Europe B.V. was a company incorporated in Netherlands. It was a 100% subsidiary of Qad Inc., USA (in short, Qad Inc.) which was engaged in the development and sale of Enterprise Resource Planning (ERP) software products. The assessee company purchased software from Qad Inc. and resold the same to multinational companies outside USA and Latin American countries.
- The assessee company entered into an agreement with M/s Hindustan Lever Ltd (HLL, in short) for the sale of licensed product, i.e. ERP software by the assessee company to HLL. Income arsing from the said transaction was treated as business income by the assessee company, and in absence of any PE in India, the same was not offered to tax in India.
- The Assessing Officer treated payment received by the assessee company on account of sale of ERP software product to HLL as 'Royalty'.

Held

- • It is noted that the said agreement does not permit HLL to carry out any alteration or conversion of any nature, so as to fall within the definition of 'adaptation' as defined in Copyright Act, 1957. The right given to the customer for reproduction was only for the limited purpose so as to make it usable for all the offices of HLL in India and no right was given to HLL for commercial exploitation of the same. It is also noted that the terms of the agreement do not allow or authorise HLL to do any of the acts covered by the definition of 'copyright'. Under these circumstances, the payment made by HLL cannot be construed as payment made towards 'use' of copyright particularly when the provisions of Indian Income-tax Act and DTAA are read together with the provisions of the Copyright Act, 1957.
- It is also noted that DTAAs of few countries make a specific mention that payment made for software would be included within the definition of 'Royalty'. Reference can be made to the DTAA with Malayasia, Romania, Kazakhistan and Morocco. However India Netherlands DTAA does not include software while defining 'Royalty'.Under these circumstances, it would be difficult to

characterise the payment received by the assessee on account of sale of software as payment received on account of 'Royalty'.