SC Ruling on Taxation of Overseas Software

Why in news?

- The Supreme Court held that the amounts paid by Indian companies for the use of softwares developed by foreign companies do not amount to 'royalty.'
- Also, such payments do not give rise to income which is taxable in India.

What does this mean?

- The SC has followed the globally-accepted interpretation.
- Accordingly, payment made by end-users and distributors is akin to payment for sale of goods.
- It is not for grant of licence under the Indian Copyright Act.
- So, the buyer only gets the right of use, and not the intellectual property of the software.
    - Only where copyright in the software is permitted to be exploited by the payer can the payment take the character of royalty.
- Indian companies thus need not deduct tax for the amount they pay to foreign manufacturers and suppliers for use or re-sale of computer software through end-user licence agreements (EULA).
- This ruling should now prevent similar disputes, but a few questions still require deliberation.

What are the unaddressed issues / challenges?

- **Refunds** - Both Indian payers (importers) and non-resident sellers must evaluate the impact of the ruling on pending disputes.
- The underlying issue has been put to rest.
- So now, the taxpayers will be looking to obtain refunds of taxes paid against demands raised or taxes paid by way of withholding tax deposited.
- In cases where this aspect has not been disputed in the past, fresh claims for refunds will have to be lodged.
- This will be either by the non-resident payee or resident payer depending on the type of contracts.
- Thus, review of the contracts for software supplies is necessary to determine eligibility for refunds and lodge claims.
- For refund claims barred by the statute of limitations, taxpayers may need to approach the Central Board of Direct Taxes for directions for grant of refund.

- **Foreign tax credits** - Another impact is on the foreign tax credits (FTC) claimed by non-resident sellers in their home-country against the taxes paid or withheld in India.
- Such non-residents will have to ascertain the right quantum of FTC credit claimed in their home-country.
- They will then have to evaluate the risk of reversal or reduction of claim.
- **TDS** - There are many resident payers who adopted a non-taxability position at the withholding stage.
- But given the different stance of the tax laws, demands were raised/tax recovered from the purported failure to withhold tax at source.
- In such cases, the payers may have recovered back-taxes from the non-resident payees, invoking tax indemnification clauses under the contract.
- Such non-resident payees may now seek a refund from the payers.

How will the ruling benefit?

- The ruling brings much-needed certainty on characterisation of software transactions.
- This is especially true for non-resident taxpayers facing the ire of the retrospective amendments.
- The rationale laid down by the apex court will be relevant for all pending cross-border tax disputes.
- However, the non-resident taxpayers will have to ensure that they meet the eligibility for treaty entitlement such as beneficial ownership and evidence of a valid tax residency.
- Given the stakes involved, it is certain that the government treasury has to pay a few hundred crore in refunds.
- The ruling, however, provides clarity in interpreting tax laws applicable to cross-border transactions and reassuring taxpayers.

Source: Financial Express