

# Tax Hotline

February 18, 2021

## SOFTWARE BATCH APPEALS - COURTROOM PROCEEDINGS (DAY 4: FEBRUARY 16, 2021)

Balbir Singh, Additional Solicitor General of India, continued his arguments Arguments for the Revenue in the Software batch of appeals before the Supreme Court of India on 16 February 2020. The arguments are summarised below:

### 1. India's Position on OECD Commentary and Tax Treaties

Singh set out India's position with respect to the India-USA tax treaty by relying on two High Powered Committee reports from the Ministry of Finance. In the Report on E-Commerce and Taxation, 1999, the committee examined various categories of e-commerce transactions that had been set out by the technical advisory group of the OECD. He directed Court's attention to the opinion of the committee on a transaction category which dealt with "limited duration software and other digital information licenses". The committee examined the provisions of the India-UK and India-US tax treaties, and found that payments made under this category constituted "royalties" for the purposes of those tax treaties. Further, the Committee extended this position to other relevant transaction categories as well, such as payments for single use software, and payments for application service providers.

He then referred to the Report of the Committee on Taxation of E-Commerce, 2016, which observed two major differences between the positions of the OECD and India on taxation of royalties. First, whilst the OECD Model allocated taxing rights on royalty exclusively to the jurisdiction where the taxpayer was a resident, Indian tax treaties allocated "source" taxing rights on the item of income, in accordance with the UN Model. *Secondly*, he contended that the position developed by the OECD on taxation of royalty from software was based on governmental views of OECD member countries, and did not represent the views of the Indian Government. As a consequence, the committee had stated that the OECD commentary would not be applicable unquestioningly whilst interpreting provisions corresponding to Article 12 of the OECD Model.

He also argued that this position was reflected in the OECD Commentary itself, which stated that in cases of software sales where there may be a transfer of rights presented as an alienation of property, the national intellectual property law should be applicable in examining the facts of the case. Singh also pointed out that the OECD Commentary itself noted that India reserved the right to tax royalties at source and to define these royalties with reference to its domestic law. The Committee also took note of India's reservation with respect to its position on certain interpretations of the Commentary on Article 12, as India held the view that some of the payments discussed might not have constituted royalties.

### 2. The role of Reservations in interpreting Tax Treaties

Having highlighted that the Indian position was noted by the OECD as a Reservation, Singh cited a tax ruling from Australia<sup>1</sup> in order to explain that a country's reservations to the OECD Commentary should be given adequate weight whilst interpreting corresponding provisions in tax treaties concluded by that country. It further held that the Reservations were supplementary guides for the interpretation of treaties under Article 32 of the Vienna Convention on the Laws of Treaties. On this basis, Singh submitted that the Indian Reservation in the OECD Commentary must be considered for the interpretation of tax treaties.

### 3. Conflict between International Law and Domestic Law

Singh cited *G.M.Exports*,<sup>2</sup> in which the Supreme Court had held that in situations where general rules of international law were employed to interpret treaty obligations, thereby resulting in conflict between international law and domestic law, then domestic law would prevail. He contended that although the case dealt with a consensus-based multilateral treaty and not a bargain-based bilateral treaty (as under the current facts), it should still be relied upon. He used this to further his submission that India's reservation to the OECD commentary, which had been noted by the OECD and never been objected to, should prevail. Singh argued that for the purposes of interpreting "royalty" under the tax treaty, if the consideration paid amounted to royalty under any of the clauses in explanation 2 to section 9(i)(vi) of the ITA, which defines "royalty", then that position would prevail over OECD's position with respect to the interpretation of "royalty" under the treaty.

### 4. Applicability of the Copyright Act to Distributors

Singh submitted that Section 14 of the Copyright Act defined a copyright as the exclusive right to do or authorise the doing of any act from a list of acts enumerated therein. He pointed towards Section 14(b)(ii) which states that the exclusive right to sell, or give on commercial rental, or offer to do so, any copy of a computer programme, would constitute a copyright. Referring to the distribution agreement between IBM Singapore and IBM India, Singh submitted that the distribution rights fell under Section 14(b)(ii), and thus constituted a transfer of copyright.

## Research Papers

### New Age of Franchising

June 20, 2025

### Life Sciences 2025

June 11, 2025

### The Tour d'Horizon of Data Law Implications of Digital Twins

May 29, 2025

## Research Articles

### 2025 Watchlist: Life Sciences Sector India

April 04, 2025

### Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

## Audio

### CCI's Deal Value Test

February 22, 2025

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

Further, Singh referred to Section 51 of the Copyright Act, which states that a copyright is infringed when a person imports infringing copies of the copyrighted work into India without a license from the owner. An “infringing copy” has been defined under the Copyright Act, in the context of imports, to mean a copy imported in contravention of the provisions of the Act. Reading these two definitions together, he submitted that the only means of importing a software lawfully was to do so with a license from the owner, as under Section 30 of the Act. Relying on the definition of license under Section 30, he submitted that the distributor had been granted an “interest in the copyright”.

## 5. Applicability of the Copyright Act on Users

Singh referred to the protection granted to users under Section 52 of the Copyright Act, which provides that “fair dealing” with the work is an exception to infringement. He argued that this protection is inapplicable to the users in the present case, as Section 52 protects the making of copies or adaptation of computer programmes for non-commercial personal use only. Further, he argued that as the users in the present case are enterprises, which make copies not for personal use, but for the purpose of business, they could not avail the “fair dealing” protection. He submitted that the agreement had given the user a right to do certain acts which the user would otherwise not have been allowed to do, under the Copyright Act.

## 6. Inapplicability of the Exhaustion Doctrine

As per the “exhaustion” or “first sale” doctrine, once a copyrighted article is sold by the owner of the copyright, she exhausts all rights to control that particular article, although the copyright continues to vest with her. Singh argued that this doctrine would not be applicable to the present case. He relied on a judgment of the Ninth Circuit Court of Appeals of the US<sup>3</sup> which dealt with the invocation of exhaustion doctrine with respect to software purchases. The Court observed that the “first sale” exhaustion doctrine is a defence against copyright infringement, that allows owners of copies of copyrighted works (as opposed to owners of the copyright) to resell these copies. In this case, the Court found that the user was a licensee and not an owner, as the terms of agreement specified that the user was only granted a license. It was observed that this license also restricted the user’s ability to transfer the software further, and imposed notable user restrictions. The Court held that as the user was a licensee, they were restricted from invoking the doctrine.

Singh also relied on a decision of the Delhi High Court in *John Wiley*<sup>4</sup> which discussed the applicability of the exhaustion doctrine in the Indian copyright framework; although it dealt with copyrights in books and not software. The High Court held that the doctrine of “first sale” might, at most, exhaust the rights of the exclusive licensee, but does not exhaust the rights of the owner of the copyright. On this basis, Singh submitted that the doctrine of exhaustion would not be applicable under the copyright framework in India, particularly for software purchases.

## 7. TCS judgement inapplicable to copyright law

Singh stated that the *TCS* judgment<sup>5</sup> was relied upon in a few High Court cases to hold that the payment for computer software did not constitute royalty. This observation was made on the basis of the Supreme Court’s ruling in which they held software embedded into material products to constitute “goods”. Noting that the issue before the Court in *TCS* was limited to whether the software products were ‘goods’ under the Andhra Pradesh General Sales Tax Act, he underscored the Court’s observation in *TCS* that the test for “goods” is not whether the property is tangible or intangible, but whether it is capable of abstraction, consumption, transfer or other similar features. Further, Singh stated that the Court in *TCS* held that definitions under the Copyright Act could not be applied to an issue under the Sales Tax Act as the two legislation should not be equated. On this basis, he submitted that the High Courts’ reliance on *TCS* is improper, as the judgment itself notes that it should not be applied from a copyright law perspective.

## 8. Explanation 4 to Section 9 only clarifies what had already been the law

Singh cited Circular No. 152 of 1974, which clarified that the withholding requirement under section 195 applied to “royalty for the use of, or the right to use, any copyright.” He compared this to Explanation 4 to Section 9(i)(vi) of the ITA, introduced through the Finance Act of 2012 which clarified that “the transfer of all or any rights” had always included the “transfer of all or any right for use or right to use a computer software”. He emphasized on the phrase “right for use or right to use” which was common to both the 1974 Circular as well as Explanation 4, and argued on this basis that the understanding of royalty under Explanation 4 has always been the position of law as indicated by the 1974 Circular.

Singh contended that Explanation 4 was only declaratory in nature because it states that it is “for the removal of doubts.” He referred to the Notes of the Finance Act, 2012, which stated that the explanation was intended to restate the legislative intent and clarify that the consideration paid for the use of computer software or the right to use computer software was always royalty. This was in context of conflicting judicial decisions on the matter.

He also noted that some of the agreements in question had acknowledged that there was a requirement to withhold tax.

Based on the assertions made above, Singh rebutted the petitioners’ argument regarding the retrospective tax liability being an impossible obligation, as it had not existed at the time of payment. He submitted that Explanation 4 only clarified a settled position that had been observed as early as 1974; and that this position was acknowledged by some of the petitioners themselves. He further stated that safeguards under Sections 195 and 197 were available to the petitioner for seeking clarification on their liability.

Percy Pardiwala, representing IBM, rebutted the submissions made by the Additional Solicitor General. He characterised the Revenue’s statement that the appeals only involved payers who had an obligation under section 195 as inaccurate, since he was himself appearing for recipients in a number of appeals. He made the following points.

## 1. Applicability of tax treaty for sum chargeable under section 195

Pardiwala observed that the wording of Section 195 is different from all of the other withholding provisions under the ITA, so far as Section 195 deals with “any sum chargeable” under the Act, instead of a defined head such as

salaries, dividends, or interest on securities, which is the case with other withholding provisions. Thus, he contended, the payer is put in a position to determine whether there is a chargeable sum under the Act for which the payer would have to refer to section 5 of the ITA. Section 5 defines the scope of total income under the Act but makes itself subject to the provisions of the ITA. Singh argued that Section 90, which incorporated the India-US tax treaty into the Act, is one such provision which Section 5 is subject to.

He cited *GE India Tech*,<sup>6</sup> where the Supreme Court had observed that the withholding obligation of the payer were limited to the appropriate proportion of income chargeable from a gross sum, which may have included other payments. It held that provisions of the tax treaty could be taken into account when deducting tax at source under Section 195.

Further, Pardiwala referred to Circular 10 of 2002 which clarified certain issues regarding the payer's liability under Section 195 of the ITA. This circular was relied upon in the proceedings on Day 2 to show that the Central Board of Direct Taxes had itself acquiesced to the position that sale of software was business income, and not royalty. In furtherance of the current point, he pointed out that the Circular itself acknowledged that the rate of deduction under the tax convention, was considered applicable for the purposes of Section 195. Hence, he submitted that the tax treaty could be applied to determine liability under Section 195.

## 2. Payer is an Assessee under the ITA

Singh had previously argued that provisions applicable to an "assessee" (such as the provision to claim the benefit of the tax treaties) could only be invoked by the recipient and not the payer. In rebuttal to this argument, Pardiwala referred to the definition of "assessee" under Section 2(7), which included every person deemed to be an "assessee in default" under the ITA. In the present case, the Revenue Department deemed the payers to be "assesses in default" for failing to fulfil their withholding obligation. Thus, Pardiwala argued, that since the payers were assesses in default, they would be considered assesses under the ITA, and as such, the provisions applicable to an assessee (including the overriding effect of tax treaties according to Section 90), would be applicable to the payers as well.

## 3. *PILCOM* judgment is inapplicable to Section 195

Singh had also relied upon the Supreme Court's judgment in *PILCOM*<sup>7</sup> to argue that tax treaties do not affect the withholding tax obligations of the payer. To counter this, Pardiwala pointed out that the case was in context of Section 194E, which dealt with the payment of income towards non-resident sportsmen. The payable sum therein is defined in Section 115BBA in relation to sports activities, and clearly sets out the obligation of the payer. As opposed to this, the obligation under Section 195 requires the payer to determine the chargeable sum. Since there was no question of chargeability in *PILCOM*, and on the basis of Supreme Court's decision in *GE India* holding tax treaty provisions to be applicable for the determination of withholding liability, Pardiwala contended that the findings of *PILCOM* must only be limited to the interpretation of liability under Section 194E.

## 4. Article 30 only deals with Entry into Force and is not a general provision

Referring to Singh's submission regarding the provisions of tax treaties being inapplicable to withholding taxes in India, on the basis of Article 30 of the India-US Tax Treaty, Pardiwala pointed out that this Article only addressed the time period during which the treaty's provisions would begin their operation with respect to different taxes. He stated that though the US provided different dates of entry into force for withholding taxes, India chose to begin the time period of applicability for all taxes from the same date. Hence, he contended, India did not feel the need to specify "withholding taxes" separately while deciding dates for entry into force of the treaty provisions. Further, he noted, such a provision is not present in the India-Singapore tax treaty, and is hence not a generic rule on the applicability of treaty provisions to certain taxes. Pardiwala argued that the difference in Article 30 should only be understood in the context of entry into force of the provisions, and should not be used for interpretation of applicability of the treaty on withholding taxes in India.

Pardiwala continued with his rebuttals on Thursday, February 17, 2021, which we shall report in the final hotline in this series.

– Arijit Ghosh & Dhruv Sanghavi

(\*We would like to acknowledge input from Pranav Mihir Kandada for the preparation of these notes.)

You can direct your queries or comments to the authors

---

<sup>1</sup> TR 2001/13.

<sup>2</sup> (2016) 1 SCC 91.

<sup>3</sup> *Vemur v. Autodesk Inc.* 621 F.3d 1102 (9th Cir. 2010).

<sup>4</sup> 2010 SCC OnLine Del 2000.

<sup>5</sup> (2005) 1 SCC 308.

<sup>6</sup> (2010) 10 SCC 29.

<sup>7</sup> (2011) 335 ITR 147.

## DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

