

# SC throws light on global taxes

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BANGALORE: The Supreme Court's decision in TCS's case that shrink-wrapped software is a 'good' and thus liable to sales tax, is likely to have a positive offshoot effect, at least on one front. This decision will provide some clarity in the realm of international taxation.

The reason is that the Supreme Court (SC) in its decision points out that in case of shrink-wrapped or off-the-shelf products, the copyright in the program remains with the originator of the program.

"In other words, there is no transfer of copyright. This observation provides clarity that payment made for purchase of shrink-wrapped software should not be treated as royalty, explains Shefali Goradia, head, international taxation, Nishith Desai Associates.

Last fiscal, tax authorities levied huge demands on Indian importers of shrink-wrapped software.

The contention of the tax authorities was that such payments constitute royalty in the hands of the foreign exporters. Thus, the Indian payer's ought to have deducted tax at source.

Under the Income-tax (I-T) Act, 1961, the rate of withholding tax for royalty payments is 20%, though it can be as low as 10% under the provisions of a few tax treaties. This issue is still pending at various levels of appeal.

The definition of royalty under the I-T Act, means the transfer of all or any rights in respect of any copyright, literary, artistic or scientific work. Even the Organisation of Economic Co-operation and Development (Oecd) in its model convention defines royalty to include the use of a copyright.

Further, Oecd's commentary points out that payments made for shrink-wrapped software, which is put to general use is not a royalty payment.

"Under the Indian Copyright Act, a buyer of a book is eligible for its fair use. Similarly, a lawful possessor of a shrink-wrapped software is eligible for its general use, including the right to make copies. There is no transfer of Intellectual Property rights in either case. Thus if purchase of a book is regarded as an outright purchase and not a royalty payment, the same treatment should be meted out for shrink-wrapped software," explains Nitin Karve, partner BSR & Co.

A senior official of a large software company adds, "The SC's decision strengthens the argument that Indian importers need not deduct tax at source on import of shrink-wrapped software."

A few countries have held that sale of a shrink-wrapped software is sale of a copyrighted product (such as a book) and not a transfer of a copyright. Thus, the payments made for it do not constitute Royalty. Both the United States and Australia have taken such a view.

CBDT, based on the recommendations of the Emerging Task Force, is currently discussing the issue of withholding taxes when software - both shrink-wrapped and customised, is imported into India. A draft circular is expected to be issued this month. Till the issue of this draft, everyone in the industry is keeping their fingers crossed.

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