

Tax Hotline

May 14, 2019

PAYMENTS FOR ONLINE SUBSCRIPTION SERVICES NOT TO BE TAXED AS ROYALTY

- The ITAT affirms that fees paid for accessing an online database should not be treated as royalty or FTS but rather business income.
- Distinction made between provision of a copyrighted article and the grant of a right to use copyright.
- Human intervention again held to be a pre-requisite for any service to be characterized as managerial or technical services.
- In another case, the ITAT held that income earned from distribution of channels by a non-resident in India should not be treated as royalty as there was no transfer of right to use copyright.

Recently in the case of *Elsevier Information Systems GmbH v. Dy. Commissioner of Income Tax (IT)*¹, the Mumbai Bench of the Income Tax Appellate Tribunal ("ITAT") has held that subscription fees charged by a service order for access to an online database should be considered as business income and not "royalty" or "fees for technical services" ("FTS"). Also, in another ruling in the case of *Commissioner of Income Tax (IT) 3 v. M/s MSM Satellite (Singapore) Pte. Ltd.*², the ITAT has held that income earned by a broadcaster of channels from subscription fees could not be considered to be "royalty" on a similar premise.

*Elsevier Information Systems GmbH v. Dy. Commissioner of Income Tax (IT)*³

FACTS:

Elsevier Information Systems GmbH, is a company which is a tax resident of Germany (the "Taxpayer"). The Taxpayer maintains an online database named "Reaxys" pertaining to chemical information including articles on chemistry topic, substance data and inputs on preparation and reaction methods which have been experimentally validated. The Taxpayer provides access to this database to its customers globally and earns a subscription fee in return.

In the course of assessment proceedings, the Taxpayer submitted that the subscription fee received by it from its Indian customers should be considered as business income and hence, should not be taxed in India in the absence of a Permanent Establishment ("PE") in India as per the definition contained in Article 5 of the India Germany Double Taxation Avoidance Agreement (the "Treaty"). The Assessing Officer ("AO") after reviewing the information including copies of the Taxpayers' agreement entered with its customers and invoices raised on them took the view that the subscription fees charged by the Taxpayer should be considered as royalty or Fees for Technical Services ("FTS"), and hence, should be taxable in India.

The AO took a view that the database is akin to a very well-equipped library of relevant information with a knowledgeable librarian who provides instant required information on demand as the database is managed in such a manner that the customer can get the desired result without much effort due to the execution tools embedded in the database.

The AO observed that Reaxys provides historical data belonging to a very technical domain of chemical substances dating back to 1771 which are excerpted from journals and articles collated through a careful selection process and structured carefully to meet controlled selection criteria. He held that this activity could not have been done without technical expertise and a human element and hence, the subscription fee has to be treated as fees for technical services. Further, the AO also concluded that online database is in the nature of literary work, and hence, the subscription fees paid for access to it should be treated as royalty under section 9(1)(vi) of the ITA. The AO held that the subscription fees is also in the nature of royalty under the Treaty, since it amounts to transfer of right to use of a copyright. On this basis, the AO decided that the subscription fees paid by the Indian customers to the Taxpayer should be taxed in India at the rate of 10% as per the provisions of the Treaty.

This was challenged by the Taxpayer before the Dispute Resolution Panel ("DRP") which decided in favour of the revenue. The Taxpayer preferred an appeal against the order of the DRP before the ITAT.

ISSUE:

Whether the subscription fees received by the Taxpayer from its Indian customers should be treated as being in the nature of "royalty" or FTS, and taxed in India as a result.

RULING:

The Taxpayer argued that the definition of royalty under Article 12 of the Treaty is narrower than the definition of royalty under the Income Tax Act, 1961 and submitted, while providing access to the online database, the Taxpayer does not give its customers any right to use the copyright in the database. There is no transfer of any ownership rights such as right to copy the database for reproduction and sale, right to grant license to any person who wishes to

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use the database, etc. to the customer. The Taxpayer also submitted that it does not share its experience, technique, or methodology employed in evolving the database with the subscriber and does not provide any right to the subscriber to use any industrial, commercial or scientific equipment. Further, the articles in the database are collated from various magazines and journals which are available publicly and hence, the subscription fee for providing publicly available information should not be treated as royalty. The ITAT referred to the judgment of the Authority for Advance Ruling in *Dun & Brad Street Espana, S.A., In Re*,⁴ and that of the ITAT in *ITO v. Cedilla Healthcare Limited*,⁵ and *DCIT v. Welspun Corporation Limited*⁶ which had also been delivered on very similar facts in favour of the taxpayers, while arriving at its conclusion.

The Taxpayer pointed out that as per the definition of FTS under the Treaty, payment of any amount for services of managerial, technical or consultancy nature including the provisions of services by technical or other personnel are in the nature of fees for technical services. It was argued by the Taxpayer that providing access to the database is not in the nature of managerial, technical or consultancy service merely because the subject matter of the database is highly technical. The subscribers / customers never interact with the personnel involved in the data collation there is no human intervention in the use of the database by the customers. The Taxpayer further explained that the database is designed to provide multiple answers near to the query raised by the client based on key words entered in the search engine and does not provide customized responses.

The Taxpayer tried to draw a parallel between the online database provided by the Taxpayer and the other online databases provided by Taxmann, CTR online, etc. and submitted that subscription fee received by the Taxpayer cannot be treated as FTS or royalty under the provisions of the ITA or the Treaty simply to make it taxable in India and relied upon a catena of cases to buttress its argument.⁷

The ITAT also examined the business model of the Taxpayer to understand how the income earned by it should be characterized. The database may be accessed through regular web browsers such as Internet Explorer, Google Chrome or Firefox on a twenty-four-hour basis from an agreed protocol range either authenticated via user name and password or via Internet Protocol (IP) number. The ITAT held that this is evidence of the fact that no particular software or hardware is required by a user for accessing the database once a customer enters into a subscription agreement with the Taxpayer. From a perusal of a sample subscription agreement, the ITAT found that the Taxpayer only grants a non-exclusive and non-transferrable right to the subscriber to access and use Reaxys.com and all right, title and interest in the subscribed products remain with the Taxpayer. Further, the ITAT noted that upon termination of the subscription agreement, the customer is required to delete all stored copies of items from the database and the Taxpayer also has the right to withdraw content it no longer has the right to provide. From this holistic reading of the subscription agreement, the ITAT held that providing access to the database did not involve the transfer of any right to use any copyright to its customers/ subscribers.

The ITAT placed reliance on established case law to remark that for any service to fall in the category of technical/ managerial service, human intervention is a pre-requisite.⁸ It agreed with the Taxpayer's submission that there was no material on record to evidence the human intervention in the case of the provision of access to the Taxpayer's database as there was no interaction between the Taxpayer's employees and the customers. The ITAT used the illustration of the online databases maintained by Taxmann. CTR online, etc., which had been supplied by the Taxpayer to affirm that when a subscriber accesses an online database, he or she only gets access to a copyrighted article or judgment and not the copyright itself. As a result, the ITAT concluded that the subscription fees cannot be treated as royalty or FTS for the purposes of Article 12(3) of the Treaty.

On the basis of the above, the ITAT held that subscription fee was in the nature of business income and could not be taxed in India since the Taxpayer did not have any PE in India to which the income could be attributed.

*Commissioner of Income Tax (IT)3 v. M/s MSM Satellite (Singapore) Pte. Ltd.*⁹

M/s MSM Satellite (Singapore) Pte. Ltd, is a Singapore resident company engaged in the operation of television channels in the Indian sub-continent for exhibition of various programmes ("**MSM Satellite**"). The end-users subscribe to these channels through various cable operators and pay subscription charges in return. The revenue so collected from large number of customers by different agencies after adjustment of intermediary charges paid to them, eventually reaches MSM Satellite. It was argued by the revenue department that this income of MSM Satellite from subscription charges should be treated as "royalty" for the use of copyright and brought to tax in India on this basis. After the lower authorities decided in favour of MSM Satellite, the revenue department preferred an appeal before the ITAT.

The ITAT referred to the provisions of the Copyright Act, 1957 and observed that copyright contemplates an exclusive right to do the acts which have been included in Section 14 of this Act. In the instant case, only a non-exclusive distribution right was being granted by MSM Satellite to the cable operators. The ITAT also noted that broadcast reproduction right was covered separately as part of Section 37 and not Section 14. As a result, the ITAT concluded that the income from subscription fees was not in lieu of any right to use copyright and hence could not be treated as "royalty".

CONCLUSION:

In the recent past, one of the flashpoints for tax litigation has been the characterization of payments made for cross-border services, especially for the use of software, online facilities or IT infrastructure as different courts have pronounced conflicting opinions on the subject. The rulings of the ITAT in the case of *Elsevier Information Systems GmbH* and *M/s MSM Satellite (Singapore) Pte. Ltd* are very welcome developments for taxpayers as they again affirm the distinction between consideration received for right to use a copyright versus consideration received in lieu of a copyrighted article. The former ruling is of particular significance for the increasing numbers of providers of online subscription services, including online media content and online libraries.

While the earlier debates used to be around whether a tangible good or a digital good (such as title to a book or e-book) that was being sold was a sale of a copyright or a copyrighted article, in a way, the online subscription models are further removed from the risk of the payments being categorized as royalty since only a limited right to use a copyrighted article is being provided under such circumstances. While the courts have relied on several lines of reasoning to uphold the above position, one of the reasons provided was that the database could be accessed from any browser and that no dedicated software or hardware was required. While most such services are available

through a specialized app, they are also usually accessible through other web browsers and applications. However, should there be circumstances where such specialized software or hardware is required for accessing the service, the analysis and conclusion may be different.

Nevertheless, the ruling of the ITAT in *Elsevier Information Systems GmbH* was based on a reading of the subscription agreement entered into with the users/ customers, and this again highlights the need for careful drafting of these contracts to avoid any mischaracterization of the service being provided.

– **Shashwat Sharma & Meyyappan Nagappan**

You can direct your queries or comments to the authors

¹ ITA no.1683/Mum/2015; Order dated April 15, 2019.

² ITA Nos 103 of 2017 and 207 of 2017

³ *Supra* note 1.

⁴ (272 ITR 99)

⁵ [2017] 77 taxmann.com 309

⁶ [2017] 77 taxmann.com 165

⁷ *DIT v. A.P. Moller Maersk A.S.*, 392 ITR 186 (SC); *CIT v. Kotak Securities Ltd.*, 383 ITR 001 (SC); *CIT v. Bharati Cellular Ltd.*, 330 ITR 239 (SC).

⁸ *CIT v. Bharati Cellular Ltd.*, [2010] 193 taxman 97 (SC); *DIT v. A.P. Moller Maersk A.S.*, [2017] 392 ITR 186 (SC)

⁹ *Supra* note 2.

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