Legal Issues in 'Taxation of Intellectual Property'

Topic: 'Whether Database Subscriptions ensue a Transfer in Copyright eligible for Taxation as Royalty?'

Relevant Legal Provisions

- **Section 14, The Copyright Act, 1957**

*"**Meaning of Copyright –***

For the purposes of this Act, copyright means the exclusive right subject to the provisions of this Act, to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely--

(a) in the case of a literary, dramatic or musical work, not being a computer programme,--

(i) to reproduce the work in any material form including the storing of it in any medium by electronic means;

(ii) to issue copies of the work to the public not being copies already in circulation;

(iii) to perform the work in public, or communicate it to the public;

(iv) to make any cinematograph film or sound recording in respect of the work;

(v) to make any translation of the work;

(vi) to make any adaptation of the work;

(vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

(b) in the case of a computer programme:

(i) to do any of the acts specified in clause (a);

(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programmer:

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental".

Relevant Legal Provisions (Contd.)

- **Section 9(1)(vii), Income Tax Act, 1961**

"***Income deemed to accrue or arise in India –***

(1) The following incomes shall be deemed to accrue or arise in India :—

(vii) "income by way of fees for technical services payable by—

(a) the Government ; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India…"

- **Article 7, Agreement for avoidance of double taxation of income with USA**

*"**Business Profits** –*

(1) The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein."

Relevant Legal Provisions (Contd.)

- **Article 12, Agreement for avoidance of double taxation of income with USA**

*"**Royalties and Fees for Included Services –***

(1) Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

(2) "However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State;

(3) The term "royalties" as used in this Article means :

> *(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof ;*

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(4) For purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

> *(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or*
>
> *(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."*

Relevant Case Laws (Contd.)

- **Commissioner of Income Tax & Anr. v. Wipro Ltd. [ITA 2804/2005 in the High Court of Karnataka, decided on October 15, 2011]**

*"9. On the other hand, the learned counsel appearing for the respondent submitted that the payment made by the respondent to M/s. Gartner is not by way of royalty and no part of copyright or copyright is transferred to the respondent for having access to the database. Further, the payment made by the respondent would only amount to income from business to the non-resident company, i.e., M/s. Gartner and can never be called as "royalty" as right conferred upon the respondent is only to have access to the database, which is akin to subscription made to a journal or magazine and nothing more than that. Therefore, the Tribunal has rightly allowed the appeals filed by the respondent herein setting aside the order passed by the appellant authority and the Assessing Officer and the said order of the Tribunal is justified. It is clear from the material on record that in identified cases, i.e., I.T.A. No. 2988 of 2005 and connected cases, this court, after considering the contentions, which are identical to the contentions raised in these appeals, in the light of the decisions relied upon by the learned counsel appearing for the parties in the said cases, by a separate order, held that the payment made by the respondent to M/s. Gartner, which is a non-resident company would amount to "royalty" and, wherefore, there is a statutory obligation on the part of the respondent to make tax deduction……**such right to access would amount to transfer of right to use the copyright held by M/s. Gartner and the payment made by the respondent to M/s, Gartner in that behalf is for the license to use the said database maintained by M/s. Gartner and such payment is to be treated as "royalty".** Therefore, ….**we hold that the finding of the tribunal that payment made by the respondent to M/s, Gartner, a non-resident company would not amount to royalty is not justified and liable to be set aside and, accordingly, we answer the substantial question of law in the negative in favour of the Revenue and against the respondent**…." **(emphasis supplied)***

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Relevant Case Laws

- **Director of Income Tax v. Infrasoft Ltd. [(2014) 264 CTR 329 in the High Court of Delhi, decided on November 22, 2013]**

"89. There is a ***clear distinction between royalty paid on transfer of copyright rights and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the royalty definition****. Viewed from this angle, a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of DTAA. Where the purpose of the licence or the transaction is only to restrict use of the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. The parting of intellectual property rights inherent in and attached to the software product in favour of the licensee/customer is what is contemplated by the Treaty.* ***Merely authorising or enabling a customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to transfer of rights in relation to copyright or conferment of the right of using the copyright****. The transfer of rights in or over copyright or the conferment of the right of use of copyright implies that the transferee/licensee should acquire rights either in entirety or partially co-extensive with the owner/transferor who divests himself of the rights he possesses pro tanto."* ***(emphasis supplied)***

"94. ***The incorporeal right to the software i.e. copyright remains with the owner and the same was not transferred by the Assessee.*** *The right to use a copyright in a programme is totally different from the right to use a programme embedded in a cassette or a CD which may be a software and the payment made for the same cannot be said to be received as consideration for the use of or right to use of any copyright to bring it within the definition of royalty as given in the DTAA.* ***What the licensee has acquired is only a copy of the copyright article whereas the copyright remains with the owner*** *and the Licensees have acquired a computer programme for being used in their business and* ***no right is granted to them to utilize the copyright of a computer programme*** *and thus the payment for the same is not in the nature of royalty."* ***(emphasis supplied)***

Relevant Case Laws

- **Engineering Analysis Centre for Excellence v. CIT [Civ. App. Nos. 8733-8734 of 2018 in the Supreme Court of India, decided on March 2, 2021]**

"117. The conclusions that can be derived on a reading of the aforesaid judgments are as follows:

(iii) ***Parting with copyright entails parting with the right to do any of the acts mentioned in section 14 of the Copyright Act. The transfer of the material substance does not, of itself****,* ***serve to transfer the copyright therein****. The transfer of the ownership of the physical substance, in which copyright subsists, gives the purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public, unless such copies are already in circulation, and the other acts mentioned in section 14 of the Copyright Act.* ***(emphasis supplied)***

(iv) A licence from a copyright owner, conferring no proprietary interest on the licensee, does not entail parting with any copyright, and is different from a licence issued under section 30 of the Copyright Act, which is a licence which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. ***Where the core of a transaction is to authorize the end-user to have access to and make use of the "licensed" computer software product over which the licensee has no exclusive rights, no copyright is parted with*** *and consequently, no infringement takes place, as is recognized by section 52(1)(aa) of the Copyright Act.* ***It makes no difference whether the end-user is enabled to use computer software that is customised to its specifications or otherwise****.* ***(emphasis supplied)***

Relevant Case Laws

- **Engineering Analysis Centre for Excellence v. CIT [Civ. App. 8733-8734 of 2018 in the Supreme Court of India, decided on March 2, 2021] (Contd...)**

"117. The conclusions that can be derived on a reading of the aforesaid judgments are as follows:

(v) ***A non-exclusive, non-transferable licence, merely enabling the use of a copyrighted product, is in the nature of restrictive conditions which are ancillary to such use, and cannot be construed as a licence to enjoy all or any of the enumerated rights mentioned in section 14 of the Copyright Act****, or create any interest in any such rights so as to attract section 30 of the Copyright Act…."* ***(emphasis supplied)***

"181. Our answer to the question posed before us, is that the ***amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not the payment of royalty*** *for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in Section 195 of the Income Tax Act were not liable to deduct any TDS under Section 195 of the Income Tax Act. The answer to this question will apply to all four categories of cases enumerated by us in para 3 of this judgment."* ***(emphasis supplied)***

Relevant Case Laws

- **Elsevier Information Systems GMBH, Mumbai v. DCIT (IT) 2(2)(1) [ITA 6573/MUM/2016 in the Income Tax Appellate Tribunal, decided on June 28, 2019]**

"13. As per the aforesaid definition of royalty in the tax treaty, any ***amount received for use of or right to use of any copyright or literary, artistic or scientific work, etc., can be treated as royalty****. In the facts of the present case, there is no dispute that the assessee has collated Elsevier Information Systems GmbH data from various journals and articles, which are otherwise available for subscription to the general public, and entered them into the database in structured manner. It is also clear from the terms of subscription agreement, the assessee has not transferred use or right to use of any copyright of literary, artistic or scientific work to its subscribers. What the assessee has done is, it has* ***allowed customers to access its database and utilize the information available therein for their use****. Further, it is observed, the data available in assessee's database relates to the subject of chemistry and from the list of clients submitted in the paper book it is very much clear that they are either chemical or chemical related companies. There is no material on record which could even remotely demonstrate that while allowing the customer /users to the access the database, the assessee had transferred its right to use the copyright of any literary, artistic or scientific work to the subscribers. Further, from the invoices raised by the assessee, sample copies of which are placed in the paper book, it is noticed that the subscription is period based and further the subscriber may not even use the data stored in the database. That being the case, the* ***payment made cannot be treated as royalty under Article-12(3) of the India-Germany Tax Treaty.****" **(emphasis supplied)***

Relevant Case Laws (Contd.)

- **CIT v. Microsoft Corporation [(2022) 445 ITR 6 in the High Court of Delhi, decided on May 19, 2022]**

"4…. 'Considerable arguments are raised on the so-called distinction between a copyright and copyrighted articles. ***What is a copyrighted article ? It is nothing but an article which incorporates the copyright of the owner, the assignee, the exclusive licensee or the licencee. So, when a copyrighted article is permitted or licensed to be used for a fee, the permission involves not only the physical or electronic manifestation of a programme, but also the use of or the right to use the copyright embedded therein****. That apart, the Copyright Act or the Income-tax Act or the DTAC does not use the expression "copyrighted article", which could have been used if the intention was as claimed by the applicant. In the circumstances, the distinction sought to be made appears to be illusory.' This ruling of the Authority for Advance Rulings flies in the face of certain principles.* ***When, under a non-exclusive licence, an end-user gets the right to use computer software in the form of a CD, the enduser only receives a right to use the software and nothing more****. The end-user does not get any of the rights that the owner continues to retain under section 14(b) of the Copyright Act read with sub-section (a)(i)- (vii) thereof.* ***Thus, the conclusion that when computer software is licensed for use under an EULA, what is also licensed is the right to use the copyright embedded therein, is wholly incorrect****. The licence for the use of a product under an EULA cannot be construed as the licence spoken of in section 30 of the Copyright Act, as such EULA only imposes restrictive conditions upon the end-user and does not part with any interest relatable to any rights mentioned in sections 14(a) and 14(b) of the Copyright Act…"* ***(emphasis supplied)***

Relevant Case Laws (Contd.)

- **Commissioner of Income Tax (International Taxation) v. Bio-Rad Lab (Singapore) PTE Ltd. [ITA 564/ 2023 in the High Court of Delhi, decided on October 3, 2023]**

"14.1…A perusal of the aforementioned provision shows that ***in order to qualify as fees for technical services, the services rendered ought to satisfy the 'make available' test.*** *Therefore, in our considered opinion, in order to bring the alleged managerial services within the ambit of fees for technical services under the India-Singapore Double Taxation Avoidance Agreement, the services would have to satisfy the 'make available' test and s****uch services should enable the person acquiring the services to apply the technology contained therein. (emphasis supplied)***

In our humble opinion, ***mere incidental advantage to the recipient of services is not enough. The real test is the transfer of technology and on the given facts of the case****, there is no transfer of technology and what has been appreciated by the Assessing Officer/learned Commissioner of Income-tax (Appeals) is the incidental benefit to the assessee which has been considered to be of enduring advantage…." **(emphasis supplied)***

Relevant Case Laws (Contd.)

- **The Commissioner of Income Tax - International Taxation v. Relx Inc. [ITA 630/ 2023 in the High Court of Delhi, decided on February 7, 2024]**

"10. It must at the outset be noted that Section 9(1)(vii) of the Act could have been resorted to, provided it were found to be more beneficial to the assessee when compared to the provisions of the DTAA. However, notwithstanding the above, it is apparent that the submissions addressed on this score are clearly unmerited. As is plainly evident from a reading of Explanation 2 of Section 9(1)(vii) of the Act and which defines FTS, it contemplates consideration which may be said to fall within the ambit of rendering of a managerial, technical or consultancy service. ***The mere access granted to a subscriber to the legal data base would clearly not fall within the ambit of Section 9(1)(vii) of the Act. All that the assessee does is provide access to the database. It has not been shown to be providing any further managerial, technical or consultancy service to a subscriber.*** *We, in any case, find ourselves unable to countenance the contention that the access so granted could be construed as providing services of the nature spoken of in Section 9(1)(vii) of the Act.*

11. We find that similar would be the position which would obtain when subscription fee is examined on the anvil of Article 12 of the DTAA. If the Department were to describe subscription fee as royalty', they would necessarily have to establish that the payments so received by the assessee was consideration for the use of or the right to use any copyright or a literary, artistic or scientific work as defined by Article 12(3) of the DTAA. ***Granting access to the database would clearly not amount to a transfer of a right to use a copyright. We must bear in mind the clear distinction that must be recognised to exist between the transfer of a copyright and the mere grant of the right to use and take advantage of copyrighted material. Neither the subscription agreement nor the advantages accorded to a subscriber can possibly be considered in law to be a transfer of a copyright. In fact, it was the categorical assertion of the assessee that the copyright remains with it at all times." (emphasis supplied)***

Relevant Case Laws (Contd.)

- **The Commissioner of Income Tax - International Taxation v. Relx Inc. [ITA 630/ 2023 in the High Court of Delhi, decided on February 7, 2024] (Contd.)**

15. Similarly, in order for that income to fall within the ambit of fees for included services', it was imperative for the Department to establish that the assessee was rendering technical or consultancy services and which included making available technical knowledge, experience, skill, know-how or processes. As has been found by the Tribunal, ***the access to the database did not constitute the rendering of any technical or consultancy services and in any case did not amount to technical knowledge, experience, skill, know-how or processes being made available."*** ***(emphasis supplied)***

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Conclusion

- There has been a long-standing difference of opinion between tax authorities and High Courts on the taxability of subscription fees for access to databases as ‘royalty’ or ‘business income’. There is a revenue interest involved in this question since, under double taxation avoidance agreements, royalties can be taxed in India, but business incomes cannot be unless the foreign entity has a permanent establishment in India.

- Different High Courts had taken different views on the taxability of subscription fees (such as the Karnataka High Court and Delhi High Court), leading to different outcomes for assesses in different parts of India.

- In *Engineering Analysis*, the Supreme Court has decisively settled the conflict. Granting access to online databases does not involve conferring right over or right to use copyright. It merely grants an access to the ‘copyrighted materials’ embodied in the database. Therefore, subscription fees paid do not qualify as ‘royalty’, but rather as ‘business income’.

- Further, as there is no transfer of copyright or any technical or consultancy services being rendered, the subscription fees is also not taxable as ‘fees for technical services’.

THANK YOU!
Questions?

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