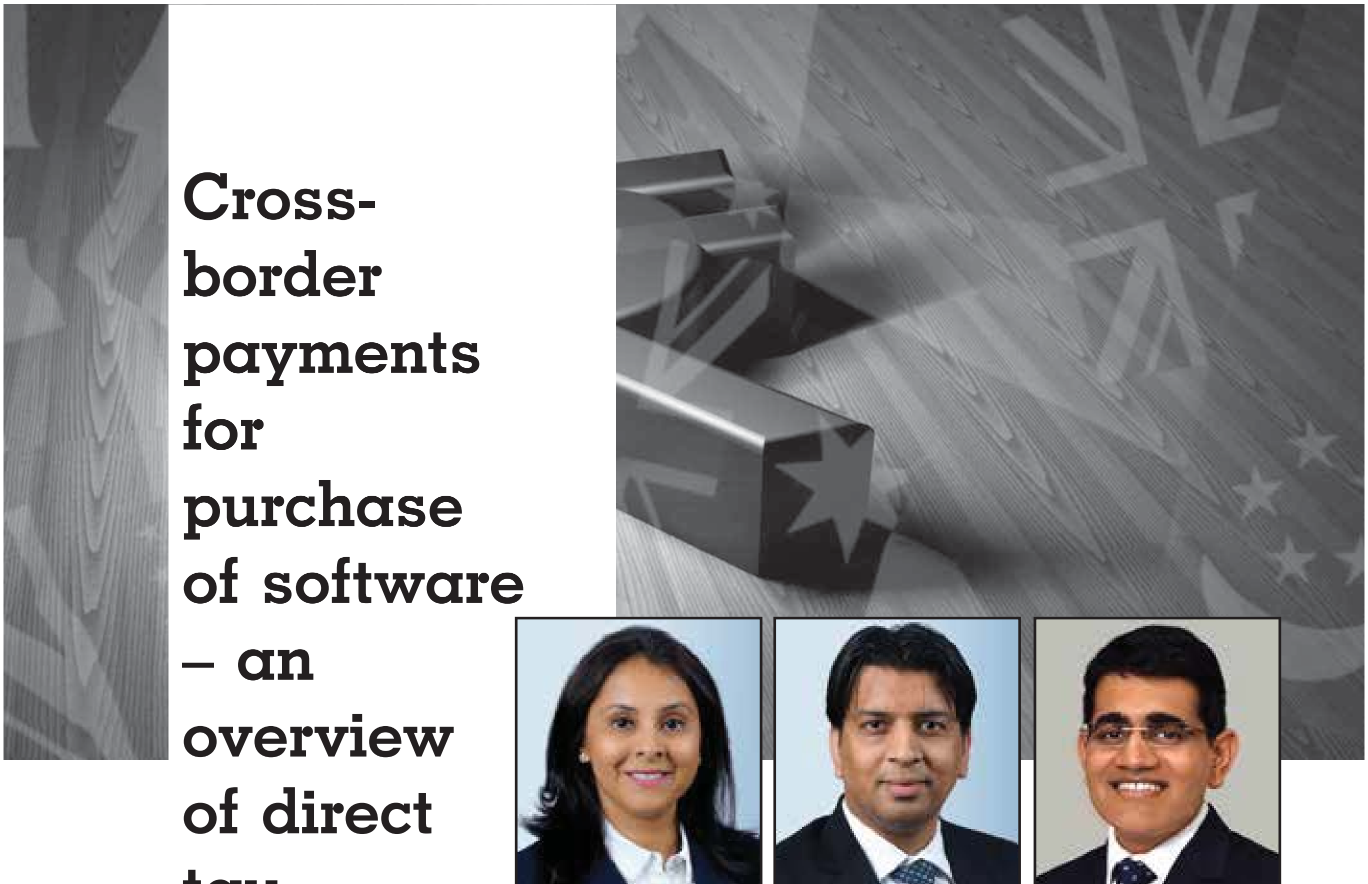

Cross-border payments for purchase of software – an overview of direct tax aspects

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INTRODUCTION

The defining theme across every industry today is digital transformation and automation of processes. The backbone of this change is computer programmes or software. It is trite to say that businesses today are constantly upgrading their systems to keep pace with technological advancements. This implies that trade (domestic as well as cross border) in software products (including newer offerings like Software-as-a-Service (SaaS)) will keep growing in times to come.

India's tax legislation vis-à-vis the software market has evolved to some extent to keep pace with advancements in the software industry, though the journey has been anything but smooth. In the Indian judicial context, businesses witnessed contrary rulings on software taxation for almost two decades vis-à-

1. Views expressed if any in this article are personal views of the authors.

vis the issue of whether cross-border income from sale of software products amounts to royalty income. It is only recently that the Supreme Court has resolved this ambivalence, to a good extent, in the landmark ruling of *Engineering Analysis Centre of Excellence Private Limited v. CIT*[2] *('Engineering Analysis')* However, with new forms of software delivery such as SaaS and new legislative provisions like equalisation levy and significant economic presence, the dust has certainly not settled on software taxation.

In this paper, the authors endeavor to give an overview of tax treatment of different types of software purchases in a cross-border context. A quick snapshot of various sections in this paper is provided below–

- Relevant provisions of the law (Indian tax law and India's tax treaties), including the Supreme Court's ruling in Engineering Analysis.
- Tax treatment for different types of software purchases (end-user, distributors, customized software, SaaS model, transfer of software with IP).
- Tax treatment for cross charge of software cost in case of Multinational Enterprise (MNE) Groups.
- Interplay of 'Significant Economic Presence' provisions with 2% equalisation levy and royalty provisions.

I. RELEVANT PROVISIONS OF THE LAW

In the cross-border context, income arising to a non-resident business on software sales to an Indian resident is likely to be in the nature of business income or capital gains, depending on the terms of the transaction and facts of each case. If the non-resident is eligible to tax treaty benefit, business income is taxable in India in case a permanent establishment (PE) of the non-resident is constituted in India (though equalisation levy may still be levied, as discussed ahead). However, in case of business income, if the income falls within the definition of 'royalty' as defined in the Income-tax Act 1961 (IT Act) read with the applicable tax treaty, then the income would be taxable as 'royalty' and not business income. Royalty income received by non-residents is taxable in India even if the non-resident does not have a PE in India.

A. Definition and scope of royalty under the IT Act (in the context of software)

- Explanation 2 to section 9(1)(vi) of the IT Act defines 'royalty' to mean consideration for, *inter alia, "the transfer of all or any rights (including the granting of a license) in respect of any copyright…".*
- Importantly, the Finance Act 2012 inserted explanation 4 to section 9(1)(vi) of the IT Act, with retrospective effect from 1 June 1976, to provide

2. [2021] 125 taxmann.com 42 (SC)

that *'transfer of all or any right for use or right to use a computer software (including granting of a licence)'* constituted royalty.

- Therefore, with the aforesaid amendment, the IT Act essentially provides that consideration for use of computer software (even without transfer of any rights in the copyright) constitutes 'royalty'.

B. Definition and scope of royalty under India's tax treaties

In the context of software, the definition of royalty varies under the numerous tax treaties that India has entered into, and can be classified into the following two categories –

<u>Category A</u>: Most tax treaties entered by India fall in this category (such as those with USA, UK, France, Germany, Singapore etc) where 'royalty' means payments of any kind received as a consideration for the use of, or the right to use, inter alia, any copyright of a literary work. In these tax treaties, consideration received for use or right to use computer software is not included in the definition of royalty.

<u>Category B</u>: India's tax treaties with Russia, Morocco, Namibia, Trinidad and Tobago define royalty in the manner given for Category A <u>and additionally</u> consider payments of any kind received as a consideration for the use of, or the right to use, any computer software programme / computer programme within the definition of royalty.

Since both the IT Act and India's tax treaties refer to 'copyright', it is relevant to analyse the definition of copyright given in India's Copyright Act 1957 (Copyright Act).

C. Meaning of 'copyright' under the Copyright Act

Section 14 of the Copyright Act provides that 'copyright' means the exclusive right to do or authorise the doing of specified acts 'in respect of a work'. Under the Copyright Act, a computer programme is considered as a 'literary work' in respect of which, the specified acts prescribed are, *inter alia:*

- Reproducing the work in any material form and issuing copies of the work to the public, not being copies already in circulation (prescribed in section 14(a) of the Copyright Act); and

- Selling or giving on commercial rental any copy of the computer programme (prescribed in section 14(b)(ii) of the Copyright Act).

D. Supreme Court ruling in Engineering Analysis

Having considered the definition of 'royalty' and 'copyright', it would be relevant to outline the law recently laid down by the Supreme Court in *Engineering Analysis* as regards the scope of what constitutes 'royalty' under the above-listed Category A tax treaties.

The key question before the Supreme Court in this case was whether payments for software (falling in any of the following four categories) can be characterised as 'royalty' under the IT Act and India's Category A tax treaties.

The Supreme Court ruled against the tax authorities' position and held that purchase of software vis-à-vis all the following four categories of assessees did not constitute payment for the use or right to use of copyright –

- Category 1 - Resident Indian buyers/ end users of computer software who purchase the same directly from a foreign non-resident supplier or manufacturer;

- Category 2 - Resident Indian traders / distributors / resellers who purchase computer software from non-resident suppliers or manufacturers for the purpose of resale to other resident Indian end-users;

- Category 3 - Non-resident vendors who, after purchasing software from other non-resident sellers, resell the same to resident Indian distributors or end users; and

- Category 4 – Non-resident suppliers who affix computer software onto hardware and then sell the same as an integrated unit/equipment to resident Indian distributors/ end users.

While the Supreme Court touched upon various aspects in this ruling, the reasoning and conclusions of the Supreme Court in the above context were –

- The transaction being undertaken is the sale of a copyrighted article, in which the end-user does not get the right to use the intellectual property rights embodied in the copyright.

- Under the End-User License Agreements (EULA), what is granted to the distributor is only a non-exclusive, non-transferable licence to resell computer software. Also, the end-user can only use the software by installing it on computer hardware and cannot in any manner reproduce the same for sale or transfer contrary to the terms imposed by the EULA.

- The 'licence' that is granted through the EULA is not a licence referred in section 30 of the Copyright Act (which transfers an interest in all or any of the rights contained in sections 14(a) and 14(b) of the Copyright Act) but is a 'licence' which imposes restrictions or conditions for the use of computer software.

- The real nature of the transactions (as evidenced by the EULAs) is the sale of a physical object which contains an embedded computer programme, and is therefore a sale of goods in view of the Supreme Court's judgement in *Tata Consultancy Services v. State of A.P*[3].

- A distributor who purchases computer software in material form and resells it to an end-user cannot be said to be within the scope of section 14(b)(ii) of the Copyright Act. The sale or commercial rental referred in section 14(b)(ii) of the Copyright Act applies only if the person has the right to reproduce copies of the computer programme and thereafter sell them or given them on commercial rental.

3. 2005 (1) SCC 308.

E. Equalisation levy provisions

While the income-tax implications for software sales under tax treaty situations is largely clear with the *Engineering Analysis* ruling, legislative changes in recent years (which were not the subject matter of the *Engineering Analysis* ruling) have brought a different dimension surrounding software taxation.

Today, software is delivered mostly through online medium such as downloading over the internet or accessing SaaS applications through an internet browser. Therefore, an understanding of India's 2% equalisation levy provisions is necessary.

Background of equalisation levy

As mentioned earlier, the present tax treaty framework entered by India provides that business income of non-residents is taxable in India if the non-resident has a PE (viz essentially physical presence) in India. However, technology has made it possible for foreign businesses to directly engage with consumers in India without having any physical presence in India. To that extent, the existence of PE (signifying physical presence) as a prerequisite for taxing business income is considered outdated by many developing countries, including India. While reformation of the international tax framework (to address challenges from digitalization of the economy) has been on the G20 agenda since 2013, a consensus-based solution remained elusive[4]. In that context, India legislated a 2% equalisation levy (EL) effective 1 April 2020, which is payable by non-residents and is outside the tax treaty framework (i.e. EL is payable in the absence of a PE). Provisions concerning the 2% EL are outlined below –

Chargeability of EL

EL is chargeable at 2% on consideration receivable by a non-resident "e-commerce operator" for "e-commerce supply or services" provided or facilitated by it to –

- an Indian resident, or
- any person who buys goods or services using an internet protocol (IP) address located in India, or
- a non-resident in 'specified circumstances'[5].

Meaning of certain terms

- An "e-commerce operator" is anyone who owns, operates, or manages a digital/electronic facility/platform for the online sale of goods or the provision of services or both.
- "E-commerce supply or services" is defined to mean the online sale of goods or services (including facilitation of the sale of such goods or services) by an e-commerce operator. Notably, the term "online sale of goods" and "online provision of services" includes any of the following activities carried out online –

4. It should be noted that on 1 July 2021, majority member countries of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS-IF) have agreed to the two-pillar solution to reform the international tax framework.
5. A discussion on the 'specified circumstances' is not very relevant to the present paper.

- o acceptance of offer for sale;
- o placing of purchase order;
- o payment of consideration; or
- o supply of goods or provision of services, partly or wholly.

Scope of 2% EL

The applicability of 2% EL is very wide-ranging and includes B2C as well as B2B transactions. The 2% EL does not define or restrict the categories of businesses covered within its scope. This means that all foreign business engaged in online supply of goods or services are covered within its ambit (subject to meeting a relevant threshold limited) such as online marketplaces, subscription-based platforms (including SaaS models), cloud services, search engines, streaming services and online gaming, among others.

Exclusions from 2% EL

An "e-commerce operator" is specifically excluded from the 2% EL charge when –

- The e-commerce operator has a PE in India and the e-commerce supply or service is effectively connected with this PE; or
- The transaction is of online advertisement and related activities where 6% EL is leviable; or
- If the turnover of the e-commerce operator (on which the 2% EL is otherwise leviable) is less than INR 20 million during the financial year; or
- Consideration received by the non-resident is chargeable to income-tax in India as royalty or 'fees for technical services'.

II. TAX TREATMENT OF DIFFERENT MODELS OF SOFTWARE SALES

A. Off-the-shelf software sale to end-user or distributor in India (without transfer of intellectual property rights)

The captioned categories of sales are covered by the Supreme Court ruling in *Engineering Analysis* and as indicated above, should not fall within the definition of 'royalty' within India's Category A tax treaties. Accordingly, sale of such software should not be chargeable to income-tax in India provided tax treaty benefit is available and the seller does not have a PE in India.

Notably, the ratio of *Engineering Analysis* ruling will apply irrespective of the medium through which the software is delivered, i.e. through online download or through delivery in the form of CD / USB flash drive.

Further, in case of distributors, the ratio of *Engineering Analysis* ruling will apply irrespective of whether the cross-border software sale is:

- By a non-resident distributor to a resident distributor; or
- By a non-resident business / software copyright owner to a resident distributor.

However, while income from the above sales would not be classified as royalty income, 2% EL will be attracted if the software is supplied online and other conditions for applicability of EL (such as threshold limit and absence of PE) are met.

On the other hand, in case Category B tax treaties apply, software sales of the above kind should be taxable in India as royalty income. However, in such a situation, 2% EL will not be payable.

B. Sale of customised software

Sale of customised software should not qualify within the definition of royalty under India's Category A tax treaties.

Notably, tax treaties entered by certain countries specifically include the right to use customised computer software within the definition of royalty (while leaving out off-the-shelf software). However, none of India's tax treaties make such a distinction between off-the-shelf software and customised software. Further, there is a view that the *Engineering Analysis* ruling does not lay down any principle regarding taxability of customised software and that it covers only off-the-shelf software. However, the authors of this paper believe that the Engineering Analysis ruling does discuss taxability of customised software.

The Supreme Court in Engineering Analysis, while summarising the views given by the Delhi High Court and Authority for Advance Rulings in decisions that favoured the taxpayer, recorded that:

> *"Where the core of a transaction is to authorise 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…. It makes no difference whether the end-user is enabled to use computer software that is customised to its specifications or otherwise."*
>
> *(emphasis supplied by us)*

The Supreme Court further went on to hold that such views have the express approval of the Supreme Court. It is also relevant to know in this context that the Delhi High Court's ruling in *DIT v. Infrasoft Limited*[6] (whose views have express approval of the Supreme Court), involved sale of customised software.

While income from above sales would not be classified as royalty income, 2% EL will be attracted if the customised software is supplied online and other conditions for applicability of EL (threshold limit and absence of PE, among others) are met.

On the other hand, in case Category B tax treaties apply, software sales of the above kind should be taxable in India as royalty income. However, in such a situation, 2% EL will not be payable.

C. Taxability of SaaS model

SaaS is a software licensing model, which allows access to software on a subscription basis using external servers. A view may be taken that income from SaaS should also not qualify as royalty income in case of Category A tax treaties, as the ratio of the *Engineering Analysis* ruling should apply even for SaaS model considering that the recipient of SaaS also does not obtain any rights to copyright of the software copyright.

6. [2013] 39 taxmann.com 88 (Delhi).

That said, since SaaS entails the word 'service' within its ambit, a question arises on whether income from SaaS can be taxed as fees for technical services (FTS)? By way of background, if business income earned by a non-resident falls within the definition of FTS (or similar term[7]) as defined in the IT Act read with the applicable tax treaty, then the income would be taxable in India as FTS and not business income. FTS received by non-residents from Indian residents is taxable in India, even in a situation where the non-resident does not have a PE in India.

The IT Act defines[8] FTS as *"any consideration for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) …"*. One may contend that income from SaaS should fall within the bucket of 'technical services' given in the aforesaid definition[9]. Such a view may draw support from the Supreme Court's ruling in *CIT v Kotak Securities Limited*[10] *(Kotak Securities Limited)*, where the Supreme Court held that services may be provided through fully automated modes in light of technological developments and departed from its earlier stand[11] that technical services must necessarily entail human efforts for provision of the service.

However, whether SaaS should be classified as FTS would depend on the facts of each case. The Supreme Court in *GVK Industries v ITO*[12] has held that in examining the terms 'managerial', 'technical' and 'consultancy', it is necessary to evaluate how the said expressions are used and understood by the persons engaged in business, and that the general and common usage of the said words has to be understood at common parlance. The commentary to the UN Model Double Taxation Convention[13] states that the ordinary meaning of the term "technical" involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Accordingly, if the service provided through the SaaS per se cannot be considered as a service requiring specialized knowledge, skill or expertise, income from such SaaS should not be considered as FTS. For instance, SaaS that uses artificial intelligence to vet contracts from a legal perspective may be considered as provision of a service, which, if provided manually, would require specialized skill or knowledge (and therefore may be taxable as FTS). On the other hand, SaaS that automates or streamlines functions / tasks for its customers that do not require specialized skill or knowledge even when provided manually (such as record-keeping, scheduling appointments, etc.) should normally not be classified as FTS.

In situations where SaaS sales are not classified as royalty income or FTS, 2% EL

7. In India's tax treaty with USA, the term used is 'fees for included services'.
8. Explanation 2 to Section 9(1)(vii) of the IT Act.
9. SaaS is unlikely to fall within the ambit of the term 'managerial' or 'consultancy'.
10. [2016] 383 ITR 1 (SC).
11. Refer *CIT v. Bharti Cellular Ltd. [2011] 330 ITR 239.*
12. [2015] 54 taxmann.com 347 (SC).
13. Refer paragraph 64 on the Commentary to Article 12A of the United Nations Model Double Taxation Convention (2017).

will be attracted as SaaS is supplied online, assuming other conditions for applicability of EL (threshsold limit, absence of PE, etc.) are met.

On the other hand, in case Category B tax treaties apply, a view may be taken that provision of SaaS should be considered as provision for software, and therefore should be taxable in India as royalty income. However, in such a situation, 2% EL will not be payable.

D. Purchase of software along with all associated intellectual property rights

In a situation where software along with all the associated intellectual property rights are transferred, income from the said transfer would not be in the nature of royalty, and instead will be considered as capital gains or business income (depending, *inter alia*, on whether the copyright constitutes capital asset for the transferor).

In this regard, it is relevant to understand the concept of 'assignment'. An assignment of copyright indicates transfer of ownership in the copyright. Assignment of copyrights is governed by Section 18 of the Copyright Act, which provides, *inter alia*, that the owner of the copyright in an existing work may assign the copyright to any person, either wholly or partly and either generally or subject to limitations and either for the whole term of the copyright or any part thereof.

As opposed to assignment, the owner of a copyright in any work may grant by way of a license 'any interest in the right', i.e. any interest in the copyright (as opposed to transfer of the copyright itself). Therefore, a licensee in the copyright can undertake acts referred to in Sections 14(a) and 14(b) of the Copyright Act to the extent allowed as per the terms of the license (which otherwise are available only to the copyright owner), but the licensee does not become the owner of the copyright itself (which happens in the case of an assignment).

The Delhi High Court in *Asia Satellite Telecommunications Co. Ltd. v DIT (Asia Satellite)*[14] brought out the distinction between transfer of 'rights in respect of property' (a phrase forming part of the definition of royalty in the IT Act) and transfer of 'right in the property', and elucidated on the scope of what constitutes royalty. Relevant excerpts of the judgement are reproduced below:

> *"55. Keeping in view the aforesaid principles, we now embark upon the interpretative process in defining the ambit and scope of term 'royalty' appearing in Explanation 2 to sub-clause (vi) of section 9(1) of the Act. Sub-clause (i) deals with the transfer of all or any rights (including the granting of a licence) in respect of a patent, etc. Thus, <u>what this sub-clause envisages is the transfer of "rights in respect of property" and not transfer of "right in the property". The two transfers are distinct and have different legal effects. In first category, the rights are purchased which enable use of those rights, while in the second category, no purchase is involved, only right to use has been granted. ….</u>*

14. [2011] 197 Taxman 263 (Delhi).

When rights in respect of a property are transferred and not the rights in the property, there is no transfer of the rights in rem which may be good against the world but not against the transferor. In that case, the transferee does not have the rights which are indeterminate in duration and residuary in character. Lump sum consideration is not decisive of the matter. That sum may be agreed for the transfer of one right, two rights and so on all the rights but not the ownership. Thus, the definition of term 'royalty' in respect of the copyright, literary, artistic or scientific work, patent, invention, process, etc. does not extend to the outright purchase of the right to use an asset. <u>In case of royalty, the ownership on the property or right remains with owner and the transferee is permitted to use the right in respect of such property. A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and, therefore, no royalty. In an outright transfer to be treated as sale of property as opposed to licence, alienation of all rights in the property is necessary."</u>

(emphasis supplied by us)

Importantly, a related principle that can be drawn from the Asia Satellite ruling is that for transfer of copyright to be considered as sale of property, alienation of all rights constituting copyright is necessary. In this determination, the terms of the transfer agreement would play a critical role.

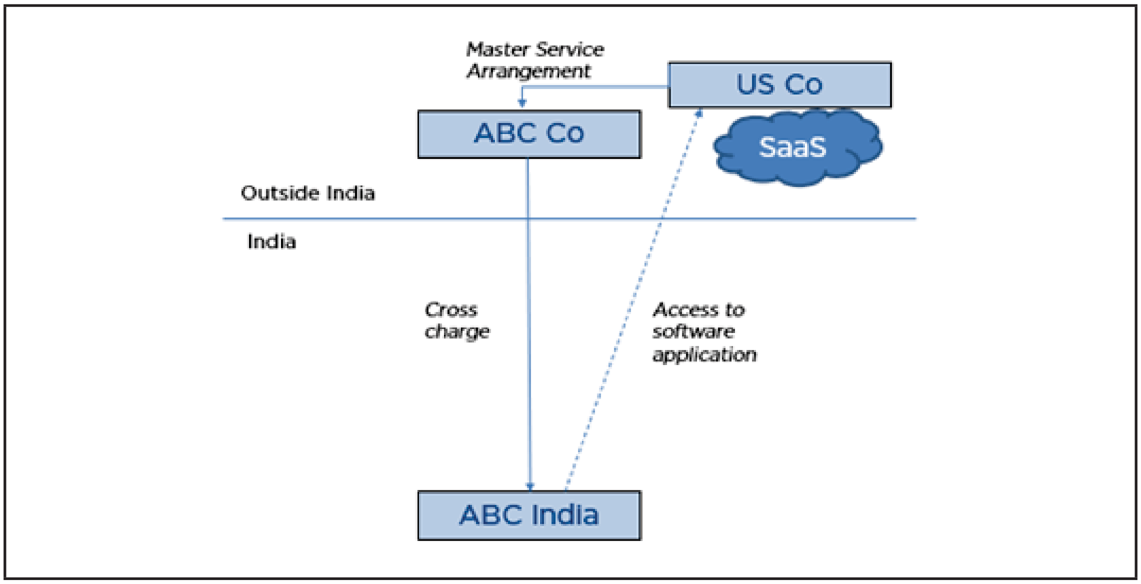
E. Software sales through physical mode such as CD / USB flash drive - equalisation levy implications

Since 2% EL applies only in case of online supply of goods / online provision of services, a peculiar situation arises where outmoded methods of software supply through physical medium such as CD / USB flash drive would not be chargeable to 2% EL. However, it should be noted that even if any of the following activities are carried out online, namely acceptance of offer for sale, placing of purchase order or payment of consideration, 2% EL may be attracted. Though from a holistic perspective, it would be pertinent to note that import of physical goods in India such as CDs, among others may have separate customs duty implications.

III. TAX TREATMENT FOR CROSS CHARGE OF SOFTWARE COST IN CASE OF MULTINATIONAL ENTERPRISE (MNE) GROUPS

A common framework for MNE groups is to have a global agreement for supply of goods or services entered between a centralised purchasing company of the group and the supplier of the good or service. In this model, the good / service is provided to group member entities in various countries by the supplier and the centralised purchasing company cross-charges group members for the cost of goods / service provided to them. Typically, the centralised purchasing company cross-charges other group companies without a mark-up and this cross-charge is considered as a reimbursement.

The taxability of such a model is analysed through the following example.



In this example, ABC Co is the central procuring company which enters into a master service agreement with US Co for certain SaaS supply to various group companies across the world. ABC Co has a group company in India called ABC India, and ABC Co cross charges ABC India for the SaaS access obtained by ABC India from US Co.

From an income-tax perspective, the tax aspects as discussed earlier would apply here as well. Income earned by US Co will not be chargeable as royalty or FTS provided benefit of Category A tax treaty is available.

As regards chargeability to 2% EL, it is worth recalling that 2% EL is chargeable where e-commerce supply or service is provided by an 'e-commerce operator' to an Indian resident. Provision of SaaS should qualify as an 'e-commerce supply or service'. In this example, if ABC Co does not own, operate, or manage a digital/electronic facility/platform for the online sale of goods or online provision of services, ABC Co will not qualify as an 'e-commerce operator' and hence should not be chargeable to 2% EL.

However, in this example, US Co will meet the definition of 'e-commerce operator'. Further, section 165A of Chapter VIII of Finance Act 2016, which is the charging section for 2% EL, provides that 2% EL is to be charged on –

> *"…the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated, by it –*
>
> *(i) to a person resident in India…"*

A reading of the above provision suggests that it is not necessary that the e-commerce operator must receive consideration only from the Indian resident recipient; the requirement is that the e-commerce operator must provide / facilitate the e-commerce supply or service to an Indian resident.

In this example, consideration is received by US Co from ABC Co, a non-resident, which per se should not lead to a conclusion that 2% EL is not chargeable. In this example, one view would be that US Co is the e-commerce operator providing e-commerce supply or service to an Indian resident. It is a settled principle of interpretation that a charging section of a fiscal statute is required to be interpreted literally[15]. If the master services agreement reads that US Co shall provide services to ABC Co and / or its affiliates, a literal interpretation can be applied to consider US Co as providing services to ABC India. If such a view is adopted, the amount on which US Co should pay 2% EL would be the consideration received by US Co from ABC Co for the service utilized by ABC India.

However, another view suggests that in the absence of a contractual relationship between US Co and ABC India, US Co cannot be considered to provide services to ABC India. If this view is adopted, 2% EL would not be payable by US Co.

IV. INTERPLAY BETWEEN SIGNIFICANT ECONOMIC PRESENCE, EQUALISATION LEVY AND ROYALTY PROVISIONS

The concept of 'Significant Economic Presence' (SEP) was introduced in India's domestic tax law in 2018, with the intent of bringing income of non-residents operating in the online / digital space (such as e-commerce, online streaming, etc.) within the ambit of India-sourced income. However, the concept of SEP remained inapplicable until recently as the thresholds for constituting SEP had not been prescribed. The Government of India has prescribed the relevant thresholds for non-residents to constitute SEP in India, which will come into force from Financial Year 2021-22.

Non-residents having SEP in India would be deemed to have a 'business connection' in India, and income attributable to the SEP would be taxable in India (except in certain cases, as discussed below). With the thresholds being notified, a non-resident will be considered to have SEP in India in either of the following situations –

(a) Transaction in respect of any goods, services or property are carried out by a non-resident with any person in India (including provision of download of data or software in India), if the aggregate of payments arising from such transaction(s) exceed INR 20 million; or

(b) Systematic and continuous soliciting of business activities or engaging in interaction with more than 300,000 users in India.

The concept of SEP is relevant in the present discussion because SEP provisions specify that transaction of download of software in India amounts to SEP in India.

15. Refer *Murarilal Mahabir Prasad v. B.R. Vad [1976] 1976 taxmann.com 16 (SC), CIT v. Ajax Products Ltd [1965] 55 ITR 741 (SC) and CIT v. Provident Investment Co. Ltd. [1957] 32 ITR 190 (SC).*

The SEP provisions therefore provide that if a transaction for download of software is carried out by a non-resident with any person(s) in India for an aggregate amount exceeding INR 20 million during a financial year, the non-resident will have a business connection in India on account of SEP.

However, the SEP provision, especially in the context of software transactions, may not have too many ramifications. This is because SEP provisions are inapplicable in the following scenarios:

(i) Tax treaty benefit is available
If tax treaty benefit is available, business income of a non-resident can be taxed in India only if the non-resident has a PE in India (even if the non-resident has a business connection in India).

(ii) If the transaction qualifies as 'royalty' or FTS under the IT Act
The concept of business connection is provided in section 9(1)(i) of the IT Act and is general in nature. On the other hand, clauses (vi) and (vii) of section 9(1) of the IT Act deal with a particular nature of income viz. "royalty" and FTS and are specific in nature. Basis various judicial precedents[16], a plausible view is that if an item falls within the specific category [of section 9(1)(vi) / (vii)], the general category section 9(1)(i) would have to yield to the specific category. Consequently, if the amounts payable fall within section 9(1)(vi) / (vii) of the IT Act, whether there is any business connection or not is of no consequence. This is further supported by the Explanation appended to sub-section (2) to section 9, which provides that:

"For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of subsection (1) and shall be included in the total income of the non-resident, whether or not,-

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India."

(emphasis supplied by us)

(iii) If equalisation levy is chargeable on the transaction
Section 10(50) of the IT Act exempts incomes chargeable to equalisation levy from income-tax. Therefore, if the non-resident is required to pay 2% EL on income from sale of software, no income-tax should be payable on account of SEP provisions. Notably, the thresholds for both 2% EL and clause (a) of SEP provisions is the same at INR 20 million and

16. *CIT v Copes Vulcan Inc. (1987) 167 ITR 884 (Bom); Meteor Satellite Ltd. v ITO [1980] 121 ITR 311 (Guj); Hindalco Industries Ltd. v ITO [2004] 91 ITD 64 (Mum); GVK Industries Ltd. v ITO [1997] 228 ITR 564 (AP).*

by definition, 'download of software' would qualify as an 'e-commerce supply or service' for the purpose of 2% EL.

V. CONCLUSION

The Supreme Court's ruling in Engineering Analysis has been a watershed moment and has brought great relief to the industry.

However, from a forward-looking perspective, it is well-recognized that the international tax treaty framework is in an unprecedent state of flux today and importantly, the issue of software taxation has not been spared either. Many argue that with an increasing level of engagement of computer programs and other software in the economic life of States where they are used, such increasing engagement justifies the allocation of taxing rights to the user State. In line with this thought process, proposals have been floated to include use or right to use computer software as part of the royalty definition in the United Nations Model Tax Convention. In fact, the United Nations Model Tax Convention was recently amended to include Article 12B that allocates taxing rights to source jurisdictions for 'Automated Digital Services'. However, the architecture surrounding the United Nations Model Tax Convention suffers from certain inherent weaknesses (foremost being that voting on these proposals is not by Governments but by experts who vote in their personal capacity), and therefore inclusion of these proposals in existing tax treaties is certainly not a given.

On the other hand, a historic agreement recently arrived between 132[17] countries on the broad framework to address tax challenges arising from the digitalization of the economy could have imminent implications on software taxation from India's perspective. This is particularly because the statement agreed among the 132 countries (which includes India) envisages *"removal of all Digital Service Taxes and other relevant similar measures on all companies"*. However, whether (and if so, when) India's version of Digital Service Tax, viz equalisation levy will eventually be repealed is only something that time will tell.

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17. As of 11 July 2021.