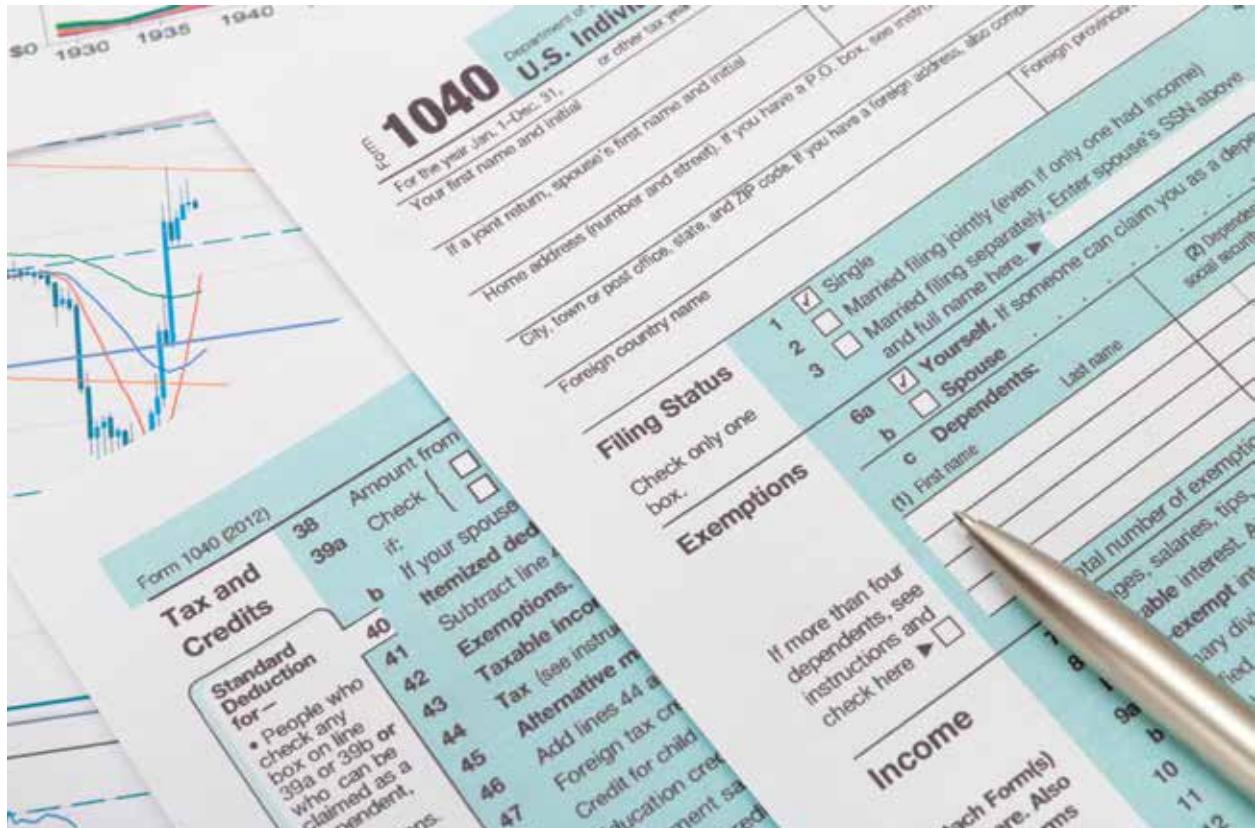


# International Taxation

## Access to Information— Analysing the Taxability



*In view of rapid globalisation, a large number of companies subscribe to several kinds of electronic database, journals, market intelligence reports, etc. These subscriptions are at times standardised and generally provide the content/database which is industry specific and may not be tailor-made, meeting the requirements of the service recipient. The subscriptions paid most often do not involve any kind of licensing. The vexed issue surrounding the characterisation and taxation of payments relating to data retrieval/access to database has been a subject matter of debate before the Courts for a long time. The controversy essentially hovers around the characterisation of payments in the nature of subscription charges/fees etc., to access the database. By way of this article, an attempt is made to analyse the judicial precedents in the Indian context. Read on to know more...*

On one side of the debate are the Taxpayers, who argue that transaction of access to database is akin to subscription made to a journal or magazine and no part of the copyright in the software is transferred. Payments made represent simply access to the information and are in the nature of business income for the provider. Consequently, such payments are not liable to tax in India in the absence of a permanent establishment ("PE") and accordingly there can be no withholding tax implications on the payer.

(Contributed by Committee on International Taxation. Comments can be sent to [citax@icai.in](mailto:citax@icai.in))

# International Taxation

**The ambiguity in taxation of such payments in the nature of subscription charges/fees etc. for data retrieval/access to database needs to be redressed both, on domestic as well as international front. While the commercial terms used for access to database may vary across business models, the facts and substance of the transactions in each case shall have to be examined to ascertain the true character of the payments.**

On the other side of the debate stands the Revenue, which argues that such payments are in effect of a licence granted by software companies to end-users. The tax authorities have majorly held that right to access a database by virtue of a license amounts to infringement of the copyright and, as such, payments made represent royalty for that licence. Consequently, such payments are liable to tax in India under the provisions of the Income Tax Act, 1961 ("ITA").

The controversy essentially hovers around the characterisation of payments in the nature of subscription charges/fees etc., to access the database. By way of this article, an attempt is made to analyse the judicial precedents in Indian context which can throw some light on this issue.

- Whether such payments would be characterised as 'Royalty' income and would consequently trigger withholding tax implications? OR
- Whether such payments would be characterised as business income and be taxable if the entity has a presence in form of a Permanent Establishment ("PE") in India?

A small example would explain as to how technology has evolved over a period of time. Earlier, there was physical access to database, reports, subscriptions etc. which has now transformed to buying virtual books, accessing the portals to buy information, electronic transmission etc. by downloading the content and acquiring the right to read without the right to reproduce/exploit and is more or less similar to buying a paperback. Viewing this from a layman's perspective, it seems logical that taxation treatment on Internet based transactions need not be different from the conventional tax system.

However, the question to be contemplated is that if that be the scenario, is there a need for the much talked about transformation in the global tax policy to match pace with the evolving technology?

Certainly not! Considering the flexibility usually associated with e-commerce business (which is primarily dominated by the evolving technological advancements), various judicial precedents, commentaries and authors have expressed differing views on these tax issues.

## Factors Impacting the Characterisation of Payments

The ambiguity in taxation of such payments in the nature of subscription charges/fees etc. for data retrieval/access to database needs to be redressed both, on domestic as well as international front. While the commercial terms used for access to database may vary across business models, the facts and substance of the transactions in each case shall have to be examined to ascertain the true character of the payments. Few of the factors which may be relevant in determining the taxability of such payments are illustrated as under:-

- a) The nature of rights granted viz. reading rights, downloading rights, commercial exploitation of rights etc.
- b) Exclusivity of rights for use of database or otherwise
- c) Nature of content of the database
- d) Right to use the process/use or right to use, any industrial, commercial or scientific equipment.
- e) Whether access to data/information requires specific software or hardware or regular internet connection would suffice.
- f) Content of information being accessed, whether raw data is compiled and provided or it intends to impart any information concerning technical, commercial or scientific knowledge.

This list is only illustrative and not exhaustive, and some of these factors may not be relevant in a particular case. All relevant facts having a bearing on the substance of the transaction should be taken into account while determining the true character of the payments so as to determine the taxability, if any, of the payments. As we go along in this article, we shall briefly deliberate upon the taxability of payments in the nature of access to database, fees for data retrieval, subscription fees etc. along with an analysis of the Indian jurisprudence dealing with the contentious issue of treatment of such payments. It may be pertinent to note that there are numerous factors associated with characterisation of payments as Royalty or otherwise and it is in itself a fact intensive exercise.

# International Taxation

## Royalty- The Indian Tax Scenario

The concept and scope of the expression "royalty" has been subject matter of prolonged litigation and reason for consequential amendments to the relevant provisions of the Act. India taxes royalties on the basis of source rule of taxation. Identifying the true nature of income sourced by a non-resident from India, is of critical importance for the purposes of determining the exigibility of such income in India.

The term 'royalty' has been defined in Explanation 2 to Section 9(1)(vi) of the Act<sup>1</sup>. Under the present definition in Section 9(1)(vi) of the IT Act, 1961 royalty includes (a) transfer of all or any rights in respect of patent, invention, model design, secret formula, etc. (b) imparting of any information in respect of (i) above (c) use of patent, invention, model design, secret formula, etc. (d) imparting technical, industrial, commercial or scientific knowledge (e) transfer of all or any rights in respect of copyright, literary, artistic or scientific work etc. (f) any services in connection with all the activities mentioned above.

The Finance Act, 2012 w.r.e.f. 1-6-1976 clarified the definition of royalty so as to include within its scope the payment made for use of any right in property, or information, irrespective of whether such right in property, or information was directly used by the payer, whether the possession or control of such right is with payer or whether the location of such right in property, or information was in India or not. In other words if there was a use, then, irrespective of possession, control with the payer or use by someone else on behalf of payer, or the location of right in property or information in India, the consideration would nevertheless be treated as 'royalty'. The net result was that if there was a use of any right in property, or information in India, the payment would be held as royalty.

Thus, for holding a payment as royalty, it was earlier considered necessary to find out where the services were rendered or where the equipments/patent/invention were used. If they were used outside India, the payment was held as not taxable in India. The amendments were made to the Income-tax Act by the Finance Act, 2012 with retrospective effect from 1-6-1976 so as to do away with the condition of rendering of services in India or use of property or information etc. in India, so long as *situs* of such property or information etc. was in India or services rendered were utilised in India.

It may also be pointed that the Memorandum to the Finance Act, 2012 stated that there are certain judicial pronouncements which have created doubts about the scope and purpose of Sections 9 and 195 of the Act. It also stated that there are conflicting decisions of various judicial authorities on certain issues in respect of income deemed to accrue or arise in India. Though it was stated in the Memorandum that the changes made were clarificatory in nature intending to provide certainty in law, the said amendments has far reaching consequences as it has overturned a number of existing judicial pronouncements favouring the assessee.

The phrase 'royalty' has, thus been very widely defined under the Act and hence, based on the above definition, one would need to analyse whether payments made in the nature of subscription/fees/charges etc. for data retrieval/access would fall under any of the above clauses of royalty definition i.e. (i) to (vi) to Section 9(1) of the Act.

## Indian Jurisprudence-An Analysis

### A. Whether payments for use of Electronic Database fall within the ambit of Royalty?

#### Issue:

The issue before the Karnataka High Court was whether payment made to foreign company for providing access to information, available in the data base maintained by the said company in foreign country is to be regarded as royalty?

#### Nature of payments/transactions:

The assessee paid subscription to a foreign company to access the business data collated, collected and maintained by it. Data pertaining to the technology/software area of business was published periodically through web and was available on subscription as well.

#### Ruling:

Bangalore ITAT in the case of Wipro Ltd.<sup>1</sup> had held that the payments to the web based publishing house giving access to the data was not covered as Royalties under Article 12(3)(a) of the Double Taxation Avoidance Agreement between India and USA and therefore not amenable to tax in India. The arguments supporting the said ruling were:

- a) Access given is to all those who are willing to pay towards publications obtaining market data.
- b) It is a copyrighted information and cannot be

<sup>1</sup> Wipro Ltd vs. ITO [2005] 94 ITD 9 (Bang ITAT)

# International Taxation

passed on to anyone else and is not a transfer of right in the copyright material.

- c) Access is restricted to specific individuals named by the assessee and fees is payable even if no service is utilised.
- d) It is more like an entry fee and not for imparting of information.
- e) The transaction is similar to purchase of a book, which allows use of information contained therein but does not transfer the copyright therein

On Revenue's appeal before the Karnataka High Court, it was held<sup>2</sup> that the payments were in the nature of royalty. The High Court held that the mere fact that in the instant case, the issue does not pertain to shrink wrapped software or off-the shelf software and access to database is granted online, would not make any difference in holding such payments to be in the nature of Royalty. It also held that the right to access the database amounted to transfer of right to use the copyright. Further, the payment made by the taxpayer to the foreign publisher was for the license to use the said database and therefore it should be treated as royalty.

## Our Comments

It appears that the Karnataka High Court has simply equated the nature of transaction of access to Electronic Database with purchase of shrink wrapped or off-the-shelf software. Enormous reliance was also placed on its own judgment in the case of Samsung Electronics Co. Ltd.<sup>3</sup> where it has been held that the payment for shrink wrapped software is in the nature of royalty. It may be noted that as on date, the assessee's appeal against the earlier judgment (in Samsung's case) is pending before the Supreme Court. It may be pertinent to note that the nature of transaction is of pivotal importance in determining its taxability. It seems that while classifying the payments as Royalty, the High Court has neither emphasised on the nature of transactions nor distinguished the same with shrink-wrapped or off-the-shelf software.

## B. Whether payments for use of Online Data Processing fall within the ambit of Royalty?

### Issue:

The issue before the Tribunal was whether payment made to foreign company towards processing of data in foreign country is to be regarded as royalty for use of 'equipment' or 'process'?

### Nature of payments/transactions:

The assessee entered into a hubbing agreement with foreign company for availing data processing support. The foreign company had a data centre in Singapore and it made available certain disc space for exclusive use of the assessee. The assessee transferred raw input data through application usage, the data was then processed at the data centre in Singapore as per the assessee's requirements and subsequently the processed data was transmitted electronically to the assessee.

### Ruling:

Mumbai ITAT in case of Standard Chartered Bank<sup>4</sup> held that the nature of payments could neither be construed towards use or right to use industrial, commercial or scientific equipment nor towards use or right to use a process. The Tribunal held that since the assessee did not have any right to access the mainframe, it could only send data to the mainframe and receive back processed data in a particular form and therefore use or right to use a process was not present in this transaction. Similarly, the assessee had no possessory rights in relation to the computer mainframe and just because it took advantage of use of a facility or use of sophisticated equipment, it could not be said that it 'used' the equipment as such. In view of the above, the Mumbai Tribunal concluded that payment for use of disc space in hardware cannot be termed as Royalty (within the meaning of Article 12(3)(b) of the India-Singapore Treaty) in guise of use of a process or towards use of industrial, commercial or scientific equipment.

## Our Comments

On the basis of the ruling of the Tribunal, it can be opined that the payments shall not be classified as Royalty for use of a facility on the basis of control over such facility by the user. Moreover, in order to consider a payment as royalty, there must be a positive act of use or possession or use of that property or

**The concept and scope of the expression "royalty" has been subject matter of prolonged litigation and reason for consequential amendments to the relevant provisions of the Act. India taxes royalties on the basis of source rule of taxation. Identifying the true nature of income sourced by a non-resident from India is of critical importance for the purposes of determining the exigibility of such income in India.**

<sup>2</sup> CIT vs. Wipro Ltd [2011] 16 taxman 275 (Kar)

<sup>3</sup> CIT vs. Samsung Electronics Co. Ltd. ITA No 2808/2005

<sup>4</sup> Standard Chartered Bank vs. DDIT [2011] 14 taxman 4(Mumb)

# International Taxation

equipment. Mere data processing charges cannot be construed as royalty, nature of services rendered is very important to come to a conclusion as to whether the payment is in the nature of royalty or not. It is imperative that there should be a real access to the whole process or to the equipment.

## C. Whether payments for information available from website fall within the ambit of Royalty?

### Issue:

The issue before the Authority for Advance Rulings (AAR) was whether payment made for electronic purchase of Business Information Reports (BIR's) to foreign company will be taxable in India?

### Nature of payments/transactions:

In this case, the applicant, a non-resident company of Spain is a subsidiary of D&B US. DBIS is the Indian subsidiary of D&B US. D&B Associates compiles information in standardised format which is electronically uploaded on the server owned and operated by D&B US. DBIS makes payments for electronic purchase of BIR's to the applicant for which DBIS is allowed access to the master server in US. DBIS would request the applicant for the BIR and would subsequently download, print and deliver a copy to the customer. DBIS is under an obligation not to take additional copies of the BIR or sell it to any customer other than customer who has raised requisition for the BIR.

### Ruling:

The AAR on the basis of factual analysis of the case observed as under:

- Information provided in BIR are said to be publicly available
- BIR is accessible by any subscriber on payment of requisite price with regular internet access and does not require any specific software or hardware
- BIR is available to public at large and does not specifically require DBIS to download the report.
- Applicant specifically averred that copyright in the BIR would neither be licensed nor assigned to either DBIS or the customer in India

In view of the above factors, the AAR in the case of Dun & Bradstreet Espana<sup>5</sup> held that payments made by DBIS to the applicant cannot be regarded as Royalty payment within the meaning of para 3 of article 13 of the India-Spain Treaty. The transaction

**It can be concluded that there are numerous factors associated with characterisation of payments as Royalty or otherwise and it is in itself a fact intensive exercise. In view of the persisting complexity in the nature of transactions, the judicial opinion also seems to be divided on this vexed issue.**

can be equated to sale of a book which does not involve any transfer of intellectual property and will be covered within the provision of Article 7 of the Treaty.

### Our Comments

It may be interesting to note the facts in the case of ONGC Videsh<sup>6</sup> where the assessee paid subscription to a website of global energy and mining research unit to get information pertaining to oil and gas industry in different countries by way of research agreement. The assessee was granted non-transferable and non-inclusive license to use secret name and passwords to download desired information from the website. The AO observed that the subscription fee was in the nature of Royalty both under Section 9(1)(iv) of the Act as well as Article 13(3) of the India UK Tax Treaty. The order of the AO was confirmed by Commissioner (Appeals).

The Delhi ITAT, while pronouncing its judgment in ONGC's case, distinguished the case of Dun & Bradstreet Espana, as the information provided in the BIR was publicly available and was only being compiled by D&B Associates. However, in the case of ONGC Videsh, the assessee sought for segmented information which had a character of intellectual property compiled on the website for the purpose of the persons in the field of oil and gas exploration and production thereof. The Delhi Tribunal held that if the totality of the facts are analysed, the information available to the assessee was made through a license, consequently it is covered under the definition of Royalty both under Section 9(1)(iv) as well as Article 13(3) of the India-UK Double Taxation Avoidance Agreement.

A well-considered view was taken by the AAR on the basis of factual analysis of the case. Since the underlying information of the BIR was publicly available which the assessee merely collated and compiled and no rights in the BIR were licensed to the end user, the payments could not be classified as Royalty. As stated in the earlier paragraph, the Delhi ITAT in case of ONGC has distinguished the AAR

<sup>5</sup> Dun & Bradstreet Espana, S.A. [2005] 142 taxman 284 (AAR-N.Delhi)

<sup>6</sup> ONGC Videsh Ltd. vs. ITO [2013] 31 taxman 119 (Del Trib)

# International Taxation

ruling and analysed that information/knowledge available is for persons in the field of oil and gas exploration and not for public at large. Moreover, such research information was available under license agreement and was technical in nature and therefore was held to be royalty.

## D. Whether payments for purchasing commercial information fall within the ambit of Royalty?

### Issue:

The issue before the Madhya Pradesh High Court was whether payment made for purchase of data in the form of monthly compilation from foreign company was taxable as Royalty in India?

### Nature of payments/transactions:

Payment was made for purchase of data of confidential nature which was in the form of monthly compilation called "Executive overview" containing data on Carbon Graphite Electrodes Industry in which the assessee is dealing.

### Ruling:

The High Court in the case of HEG<sup>7</sup> observed that the information obtained by the assessee is in the nature of a book and is not an information which would show any kind of experience skill or expertise and therefore not taxable to meet the definition of Royalty laid down in Explanation 2 to Section 9(1)(iv). The subject information was available in the market and cannot be considered as secret and confidential. The Court held that the data, although informative was publicly available and provided to all players in the industry on non-exclusive basis, and therefore in absence of an element of skill or expertise associated with the provision of data, the payment cannot be regarded as being in the nature of Royalty.

### Our Comments

Though the matter was remitted to the Tribunal for fresh adjudication after verification of entire records relating to data, the High Court has clearly held that every information would not have the status of royalty. There are various kinds of categories of information. Solely because an entry is of the commercial nature or value would not make it a royalty. That cannot be an exclusive base or foundation. Some sort of expertise or skill is required. The aforesaid factor would be the requisite one and therefore the contention, that

every information if it concerns the industries or commercial venture would be a royalty, cannot be accepted.

## E. Whether payments for accessing web portal, which also included use of software and equipment of the assessee, falls within the ambit of Royalty?

### Issue:

The issue before the Mumbai Tribunal was whether payment made for use of licensed software along with computer system to access the assessee's portal constitutes Royalty in India?

### Nature of payments/transactions:

The assessee entered into a contract with the Indian clients for providing foreign exchange deal matching system. The main server of the assessee was located in Geneva. In order to provide services to the Indian clients, the assessee also entered into agreement with its Indian subsidiary RIPL to provide the equipment and connectivity within India on behalf of the assessee. The assessee is providing the service in form of information solution to the need of the subscribers by providing the matching party. The entire system involves processing of subscriber's business queries and orders and finding out the matching reply in the shape of counterpart demand or supply for execution of the transaction of purchase and sale of foreign exchange. Peculiar facts about the arrangement/transactions are:-

- a) License to use software was on non-transferable and non-exclusive basis
- b) The clients were permitted to sub license the agreement with assessee's prior permission.
- c) The clients would avail services only through the equipment and connectivity provided by the assessee through its subsidiary RIPL.
- d) Charges for entire facility and services shall be paid by the client to the assessee. The assessee remunerates RIPL in turn for providing services of marketing and installation of equipment

### Ruling:

Mumbai ITAT in the case of Reuters Transaction Services Ltd.<sup>8</sup> observed that the instant case is not a case of simplicitor payment for access to the portal by use of normal computer and internal facility but the access is given only by use of computer system and software system provided by the assessee. The

<sup>7</sup> CIT vs. HEG Ltd. [2003] 130 Taxman 72(MP)

<sup>8</sup> Reuters Transaction Services Ltd vs. DDIT [2014] 47 taxman 10 (Mumbai-Trib)

**The Organisation for Economic Co-operation and Development (OECD) and G 20 countries adopted a 15 point action plan to address Base Erosion and Profit Shifting (BEPS) issues. Though not directly relatable, yet interesting would be the new set of standards set on account of Action Plan on Digital Economy, which would certainly have some relevance and may provide much needed clarity on the issue of characterisation of subscription income from data retrieval/use of database.**

Tribunal held that allowing use of software and computer system to have access to the portal of the assessee for finding relevant match would amount to imparting of information concerning technical, industrial, commercial or scientific equipment work and payment made in this respect would constitute Royalty in terms of Article 13(3) of the India-UK Double Taxation Avoidance Agreement.

### Our Comments

In Kotak's<sup>9</sup> case, the subscriber made payment for the activity of specialised data processing which included activities such as sending raw data to the Australian company, which was processed and transmitted back electronically to the assessee. The Assessing Officer held that such payments to be taxable as royalty as appearing in Section 9(1) of the Act as also in Article 12(3)(a) of the Treaty between India and Australia. The Tribunal held that irrespective of the fact that use of the mainframe in the course of processing of data was one of the important aspects of the whole activity, the payments were not for the use of mainframe computer per se and since the assessee did not have any control over or physical access to the mainframe in Australia, such payments could not be classified as Royalty in terms of clause 12(3)(b) of the Treaty between India and Australia.

It can be clearly seen that the facts of the above cases (*i.e.* Reuters and Kotak) are different and the difference has resulted in one transaction being liable to tax and the other not taxable in India.

### Concluding Remarks

It can be concluded that there are numerous factors associated with characterisation of payments as Royalty or otherwise and it is in itself

a fact intensive exercise. In view of the persisting complexity in the nature of transactions, the judicial opinion also seems to be divided on this vexed issue.

Evidently, the alarming innovation in technology has shaken the pillars of the conventional taxation regime. The global tax policy is still trying to match pace with the ever evolving 'Digital economy'. Developments on the international front on issues concerning the classification of various types of e-commerce income as either royalties or income from the sale of goods or income from the provision of services would be noteworthy. The Organisation for Economic Co-operation and Development (OECD) and G 20 countries adopted a 15 point action plan to address Base Erosion and Profit Shifting (BEPS) issues. Though not directly relatable, yet interesting would be the new set of standards set on account of Action Plan on Digital Economy, which would certainly have some relevance and may provide much needed clarity on the issue of characterisation of subscription income from data retrieval/use of database.

<sup>i</sup> "royalty means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

- (i) the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in Section 44BB;
- (v) the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v)." ■

<sup>9</sup> Kotak Mahindra Primus Ltd. vs. DDIT [2007] 11 SOT 578 (Mumb)