

## **Software licensing payments are royalty and taxable, rules Tribunal**

*Microsoft case verdict goes in favour of Revenue Department.*

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*Software firm hit hard*

*End-user payments for licensing of software to be treated as 'royalty'*

*Microsoft says payments made towards licensing of software cannot be treated as royalty*

*Payments made to Microsoft prior to Jan 1, 1999, also taxable as royalty*

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The Delhi Income-Tax Appellate Tribunal (ITAT) has held that payments received by Microsoft Corporation from end users (in India) through distributors for sale of Microsoft software, are taxable as royalty. This would be applicable for all the payments made before January 1, 1999, the ITAT has said.

Until this date, Microsoft Corporation, a US company, had direct arrangements with various Indian distributors for sale of Microsoft software (off- the-shelf/shrink-wrapped), on a principal-to-principal basis.

From January 1, 1999, the business model was changed and Microsoft granted exclusive licence to Gracemac Corporation of the US to manufacture the Microsoft software and distribute it in terms of the licence agreement. Even under the changed business model, the ITAT has now held that payments for software licensing should be treated as royalty for tax purposes.

Disposing a batch of appeals relating to three different entities — Microsoft Corporation, Gracemac Corporation and Microsoft Regional Sales Corporation (MRSC) — relating to different assessment years, the ITAT bench upheld the ruling of CIT (appeals) that consideration received from licensing of computer software would be in the nature of royalty under the Indian Income Tax law and India-US DTAA.

Revenue Dept

This ITAT ruling comes in the Revenue Department's favour. Microsoft has been contending that payments made towards licensing of computer software cannot be treated as royalty, but should be considered as business profits. If considered as business profits, the software major would have had no tax liability here as it does not have a permanent establishment in India.

Meanwhile, in the case of Gracemac Corp, the ITAT has held that payments made in respect of copyright in Microsoft software are taxable as royalty in its hands.

Under Microsoft's changed business model from January 1, 1999, Gracemac had entered into a licence agreement with Microsoft Operations Pte Ltd, a Singapore-based wholly-owned subsidiary of Microsoft Corporation, for non-exclusive licence to reproduce Microsoft software in Singapore. Microsoft Operations sold all its Microsoft software copies to MRSC branch in Singapore. MRSC had delivered Microsoft software copies to Indian distributors, ex-warehouse in Singapore, who in turn sold them to resellers/end users in India.

Microsoft Operations paid royalty to Gracemac. The royalty was based on a percentage of net selling price received by MRSC from distributors in various countries, including India.

The Delhi ITAT has also ruled that MRSC cannot be taxed again on the same income, by way of royalty, for exploitation of same rights which had been taxed in the hands of Gracemac Corporation. Any such move would constitute double taxation and therefore the ITAT has deleted the additions in the hands of MRSC for all the three years.

***Source: The Hindu Business Line.***