Profits from offshore supply of IT equipment not taxable : Court

A recent verdict by the Delhi high court might set a precedent on the taxation of equipment that comprise hardware and software. In a case between Swedish telecom equipment maker Ericsson and the department of income tax, the court held that profits from offshore supply of equipment comprising hardware and software are not taxable in this country.

The court said if the title to the equipment passes on to Indian clients outside the country, it cannot be taxed in India, even though it is the country where the business negotiation and the signing of the contract or acceptance test were done.

The verdict drew a positive response. “This is a welcome verdict for the country’s telecommunications sector, which largely buys telecom equipment from foreign vendors like Lucent, Motorola, Ericsson and Huawei,” notes Himanshu Parekh, partner, KPMG. “This decision will also have a favourable impact on EPC (engineering procurement and construction) contracts involving overseas equipment supply and installation besides commissioning of the equipment in India.”
The court judgment also said revenues from the software embedded in hardware were not taxable as royalty income. There is no ‘transfer of rights’ in respect to the ‘copyright’ of the software.

For many companies, this will mean a shot in the arm in their fight with the tax authorities. The Delhi high court is hearing similar cases with regard to Nokia and Motorola. The orders are expected soon.

Earlier, in the cases relating to Sonata Software and Samsung, among others, the Karnataka HC had held that payments for import of software were in the nature of royalty, thus upholding the view of the income-tax authorities. Not different was the view of the Authority for Advance Rulings in a recent case relating to Millennium Software.

In another case of Lucent Technologies, the Karnataka HC, too, had held that payment for import of software integrated with hardware amounts to ‘royalty’ under Section 9(1)(vi) of the Income Tax Act, 1961. According to the Income Tax Act, once a payment is in the nature of royalty (under the provisions of Section 9), it is deemed to arise in India. This, consequently, requires the payer to deduct tax at source as per the provisions of Section 195 of the Act.

The aggrieved parties in the Karnataka HC case had said payments for import of software (especially shrink wrapped) were in the the nature of payment for import of goods and, as such, these are not in nature of royalty. Payments are being made for a ‘copyrighted article’ and not a ‘copyright’, according to the parties. The copying of the software onto the hard-disk for installation purpose is integral

to the sale of software, and does not give rise to any copyright to the user as per the OECD commentary, they added.

Sonata Software notes that the aggrieved parties in almost all the above cases have approached the Supreme Court for a final decision on the issue. “The unfortunate part,” said N Venkatraman, the company’s head (strategic finance and risk management), “is that the payments made by these companies dates back to 1998.” In case of an unfavourable decision, the outcome will be disastrous to them, he told Business Standard.

(Business Standard)