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Payment for e-learning courses and online information resources is taxable as royalty under the India-Ireland tax treaty

Background

Recently, the Authority for Advance Rulings (the AAR) in the case of SkillSoft Ireland Limited[1] (the applicant) held that e-learning course offerings, online information resources, etc. are software and computer databases created by the applicant, included within the ambit of 'literary work' and therefore, are taxable under Article 12(3)(a) of the India-Ireland tax treaty (tax treaty). Irrespective of the use of words like 'non-exclusive' and 'non-transferable' in the relevant agreements, there is a transfer of certain rights owned by the applicant. In terms of the tax treaty, the consideration paid for the use or a right to use the confidential information in the form of computer software, itself constitutes royalty.

Facts of the case

- The applicant is an Ireland based company, engaged in the business of providing on demand e-learning course offerings, online information resources, flexible learning technologies and performance support solutions (SkillSoft products).
- The applicant has entered into a reseller agreement with SkillSoft Software Services India Private Limited (SkillSoft India). Under this agreement, SkillSoft India is a distributor and has the right to license, market, promote, demonstrate and distribute SkillSoft products by providing online access to such products.
- SkillSoft India buys the SkillSoft products from the applicant on a principal-to-principal basis and sells the same to Indian end users/customers in its own name. According to the applicant, it has developed copyrighted products by using software and techniques, on several topics which were electronically stored on its server outside India.
- These SkillSoft products are licensed to Indian end users/customers under the master licence agreement between SkillSoft India and Indian end users. SkillSoft India grants to the Indian end users a non-exclusive, non-transferable license to use and to allow the applicable authorised audience to access and use SkillSoft products.
- The products consist of two components namely the course content and the software through which the course content is delivered to the end customer. Its e-learning platforms are not instructor driven and have no element of human interaction in the learning programmes. The interaction is restricted to software enabled virtual interaction through text, images and graphics that are utilised to enhance the learning experience.

Issue before the AAR

- Whether payments received by the applicant on account of e-learning course offerings, online information resources, etc. is taxable as 'royalty' under Article 12(3)(a) of the tax treaty?

[1] SkillSoft Ireland Limited (AAR No. 985 of 2010) – Taxsutra.com

AAR ruling

- The facts of the present case are similar to the case of Citrix Systems Asia Pacific Private Limited[2]. All transactions between Citrix and the distributor are on a principal-to-principal basis as in the present case.
- The ruling in the case of Citrix was pronounced after considering various relevant decisions like the case of FactSet[3], Dassault[4], Samsung Electronics Private Limited[5] and Ericsson A.B.[6] After considering all these decisions the AAR had held that the payments received from the distributor for sale of the software product are in the nature of royalty both within the meaning of Section 9(1)(vi) of the Income-tax Act, 1961 (the Act) and within the meaning of Article 12 of the relevant tax treaty.
- The taxpayer contended that the ruling in the case of FactSet is binding on the AAR and relied on the various decisions[7]. However, the AAR observed that in all these cases the emphasis was that if the facts are similar then only the ruling becomes binding.
- The taxpayer argued that the payment received by the applicant is only in respect of a copyrighted article and no rights in the copyright are granted to the Indian end-users. However, this issue has been dealt by the AAR in the case of Citrix and had concluded that such distinction is illusory.

Software as 'literary work'

- As regards the coverage of computer programme and computer database within the ambit of 'literary work' in Article 12(3)(a) of the tax treaty, the AAR in the case of FactSet held that the computer database falls within the scope of literary work. The issue was settled by the AAR in the case of FactSet where it was observed that by an inclusive definition in Section 2(o) of Copyright Act, 1957 computer programmes and computer databases are included within the ambit of literary work.
- The notification[8] issued by the Central Board of Direct Taxes (CBDT) defining Information Technology Enabled Services (ITES) does not apply to the applicant and it is meant for eligible taxpayers who have exercised a valid option for the application of Safe Harbor Rules.
- SkillSoft products consist of the software through which the course content is delivered to the end customers who gain access to specially designed software for understanding of the content. Also, the applicant is marketing several copyrighted software containing simulation exercises, specially designed by them and are not available in public domain.
- Accordingly, the software and computer databases created by the applicant are included within the ambit of 'literary work' and therefore covered under Article 12(3)(a) of the tax treaty.

Grant of non-exclusive, non-transferable rights in the license

- The applicant argued that the grant of the right to Indian end users to access the educational content should not be construed as granting of copyright. It is purely a question of fact on the basis of which it can be decided whether the nature of a license granted by the applicant would result in royalty or not.
- The Karnataka High Court in the case of Synopsis[9] observed that the taxpayer had granted a non-exclusive and non-transferable license, without providing a right to sub-license, for the use of software and design technologies. In the present case also, the reseller agreement grants to the customer a non-exclusive, non-transferable license (without the right to sub-license).
- In the case of Synopsis, the High Court observed that merely because the words non-exclusive and non-transferrable are used in the license, it does not take away software out of the definition of 'copyright'. Further, even if it is not a transfer of exclusive right in the copyright, the right to use the confidential information embedded in the software in terms of the aforesaid license indicates that there is a transfer of certain rights which the owner of the copyright possesses in the said computer software/programme in respect of the copyright owned. It is not necessary that there should be a transfer of exclusive right in the copyright.
- In the present case also similar words have been used in the reseller agreement as well as the master license agreement. Therefore, irrespective of the use of the words like non-exclusive and non-transferable in the two agreements, there is definitely a transfer of certain rights of which the applicant is the owner.

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[2] Citrix Systems Asia Pacific Private Limited [2012] 343 ITR 1 (AAR)
[3] Research System Inc., In re vs. [2009] 317 ITR 169 (AAR)
[4] Dassault Systems KK., (AAR No.821/2009)
[5] CIT v. Samsung Electronics Co Ltd & Ors. [2012] 345 ITR 494 (Kar)
[6] DIT v. Ericsson A.B. [2012] 246 ITR 422 (Del)
[7] Dun and Bradstreet Information Services Private Limited [2011] 338 ITR 95 (Bom), Linde AG, Linde Engineering Division and anr. v. DDIT [2014] 365 ITR 1 (Del), Sun Engineering Works Pvt Ltd., [1992] 198 ITR 297 (SC)
[8] CBDT Notification dated 18 September 2013
[9] CIT v. Synopsis International Old Ltd. [2012] 212 Taxman 454 (Kar)

- The Karnataka High Court in the case of Synopsis held that under the tax treaty, to constitute royalty there need not be any transfer or any rights in respect of any copyrights, and it is sufficient if the consideration is received for the use of or the use to any copyright. Therefore, if the definition of royalty in the tax treaty is taken into consideration, it is not necessary that there should be a transfer of any exclusive right.
- In terms of the tax treaty, the consideration paid for the use or a right to use the said confidential information in the form of computer software programme itself constitutes royalty. Accordingly, the payment received by the applicant are in the nature of royalty under Article 12(3)(a) of the tax treaty.

Our comments

The issue with respect to taxation of software payments has been a matter of debate before the courts. The determination of royalty is a factual exercise and the real nature of a transaction has to be ascertained. One has to consider totality of circumstances, including the intention of the parties, essence and predominant nature of the transaction, etc.

The AAR in the present case has relied on various relevant decisions and held that e-learning course offerings consist of the software through which the course content is delivered to the end-customer, are in the nature of royalty. The AAR held that though the reseller agreement grants customers a non-exclusive and non-transferable license there is a transfer of certain rights which the owner of the copyright possesses in the said computer software/programme, and therefore, the consideration received by the applicant is in the nature of royalty under the tax treaty.

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