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Payment made by distributor for procuring software from non-resident, subject to withholding tax in India

The Bengaluru bench of the Income Tax Appellate Tribunal held that payment made by a distributor for procuring software from a non-resident is subject to withholding tax in India.

Background:

- The taxpayer¹ (an Indian company) is a wholly owned subsidiary of a Jersey based entity (AE). The taxpayer was an intermediary / distributor of computer software produced by the AE for sale within the geographical territory of India. The taxpayer was also entrusted with the scope of advertising and marketing the products by organising and conducting events, exhibitions, seminars, sponsorship, etc.
- The taxpayer had not entered into an agreement with the AE but there was a letter dated 3 January 2009 (Letter) as per which it was stated by the AE that:
 - The taxpayer was eligible for a margin of 15% on the cost and it should be retained by the taxpayer; and
 - The AE will reimburse all expenses incurred by the taxpayer on salary, including directors' remuneration, advertisement, travelling and travelling related expenses, business promotion expenses, communication expenses, marketing expenses, public relations cost, seminar and sponsorship, etc., of the product, including director's remuneration, travelling expenses, marketing expenses, public relations cost etc.
- During the Financial Year (FY) 2012-13, corresponding to Assessment Year (AY) 2013-14, the taxpayer remitted a sum to its AE towards software and debited the same to its profit and loss account as software expense. The taxpayer did not withhold taxes while remitting the sum to its AE on the following basis:
 - It was only a distributor of the products and enabled the transaction (i.e. the taxpayer was acting as an intermediary) and the taxpayer did not purchase any software from its AE directly.
 - The amount debited by the taxpayer as purchase of software licence was just the price payable to the AE after retaining applicable margin.
 - The taxpayer was eligible to retain 15% margin on cost of AE and was also eligible to get reimbursement of various expenses as specified in the Letter.
 - The taxpayer did not have right to have a copy of the software.

¹ Kaseya Software India Private limited v. DCIT (ITA no 1304/Bang/2018) (Bengaluru ITAT)

- The Assessing Officer (AO) dismissed the taxpayer's contention and based on earlier judicial precedents² in this regard, disallowed the deduction for the said payment under section 40(a)(ia) of the Income-tax Act, 1961 (ITA), for failure to withhold tax at source under section 195 of the ITA.
- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the AO's order.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Bengaluru Bench of Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that the main issue in dispute was whether the sum debited to the profit and loss account by the taxpayer as software expenses was purchase of software or mere reimbursement by the taxpayer to the AE (being the cost incurred by the AE after retaining 15% of cost incurred by the AE).
- The ITAT noted the following:
 - The margin retained by the taxpayer worked out to be 15% of total purchases, whereas the letter talked about margin being 15% of cost.
 - The taxpayer had debited 'employee benefit expenses', 'marketing expenses', 'advertisement expenses' etc. to its profit and loss account. The taxpayer did not provide any clarification / details whether the same were after reimbursement.
 - As per the statement of facts filed by the taxpayer, the taxpayer obtained purchase order from the Indian customers in respect of certain IT monitoring software products of the AE as per agreed price (for which the taxpayer was acting as a distributor for distribution keys of such software).
- In view of the above, the ITAT held that:
 - The manner of fixing purchase price of the taxpayer would not alter the nature of the transaction.
 - It was not established that the contents of the letter were being acted upon. Even if it was acted upon, the conditions of the Letter about reimbursement of various expenses to the taxpayer by the AE such as salary, travelling and travelling related expenses etc. would not alter the nature of the transaction.
 - The product was produced by the AE of the taxpayer and not by the taxpayer and therefore, the amount payable by the taxpayer to the AE in this regard, was nothing but purchase price of the computer software.

The various cases² followed by lower authorities were applicable and simply because specific detailed distribution agreement was not executed between the taxpayer and the AE, it could not

² CIT v. Samsung Electronics Co. Ltd [2011] 345 ITR 494 (Karnataka HC); Synopsis International Ltd. v. CIT [2016] 28 taxmann.com 162 (Karnataka HC);

Kalki Communications Technologies Limited v. ITO (ITA. no 140/Bang/2013) (Bengaluru ITAT).

be said (as contended by the taxpayer) the said cases were not applicable, when the understanding between the taxpayer and the AE was similar.

- The arrangement between taxpayer and the AE was of purchase of computer software at agreed price.

In view of the above, the ITAT concluded that the fact that the taxpayer was a distributor did not change the nature of the transaction and it was still a purchase as accounted for by the taxpayer and the cases² followed by the AO and the CIT(A) were applicable and the issue was covered against the taxpayer. Following the said cases, the ITAT upheld the CIT(A)'s order.

Comment:

- This ruling has held that payment to foreign AE as a distributor / intermediary for procurement of software is taxable as royalty liable for withholding tax in India. Taxpayers with similar arrangements may want to evaluate the impact of this ruling to the facts of their case.



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