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Subscription to online database constitutes 'business Income' and not 'royalty'

The Mumbai Bench of the Authority for Advance Ruling gave its decision that receipt from Indian subscribers/customers for providing access to the electronic copy of content database viz. e-books/e-journals/e-articles does not constitute 'Royalty' under article 12 of India-Netherlands tax treaty, but is regarded as 'Business Income.'

Background:

- The taxpayer[1] is a company incorporated under the laws of Netherlands and is part of the group, providing professional information and online workflow solutions in the field of science, medical, legal, and risk information and analytics.
- The taxpayer serves more than 30 million scientists, students, and health and information professionals worldwide. Its products include electronic and print version of books, journals and online database solutions and covers health, life, physical and social sciences subject areas.
- The taxpayer's main product is Science Direct database which stores a host of information on subjects / topics related to science, technology and health science. It has more than 19,000 books, 3,500 journals and 11 million articles, hosted on it's web portal in electronic format.
- In India, the taxpayer entered into the following two types of transactions:
  - Pay per view transactions; and
  - Subscription agreements.

  In essence both the transactions are similar (i.e. books, journals and articles in electronic format). The only difference between the two is the business model wherein in the former type, the taxpayer allows customer to view, print or download a particular book chapter / journal article after making online payment, whereas in the latter, the customer is allowed to view, print, download, etc. various books / journals, in their entirety, or journal articles / book chapters on the subscribed topics for which a lump-sum amount is paid by the subscriber.
- The taxpayer sought an advance ruling from the Authority for Advance Ruling (AAR) on the following questions:
  - Whether the taxpayer's receipts from the Indian subscribers / customers for e-books / e-journals / e-articles was taxable as royalty as per section 9(1)(vi) of the Income-tax Act, 1961 (ITA) and Article 12 of the India-Netherlands double taxation avoidance agreement (Tax Treaty) or as 'business Income' under section 28 of the ITA and Article 7 of the Tax Treaty?

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[1] Elsevier BV, The Netherlands (AAR no 1481 of 2013) (AAR- Mumbai)

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- If the receipts are considered as business income, in the absence of any Permanent Establishment (PE) in India, would the receipts from Indian subscribers / customers be taxable in India under Article 7 of the Tax Treaty?
- If the first two answers are negative, then, whether the Indian subscribers / customers are required to withhold any tax in India (from the payment made to the taxpayer) under section 195 of the ITA?

- The key contentions of the taxpayer before the AAR, were as follows:

  Taxability of receipt as 'business income' and not 'Royalty'

  - The taxpayer was governed by Article 12(4) of the Tax Treaty (relating to taxation of royalties and fees for technical services) as the same was more beneficial as compared to the provisions of the ITA.
  - Both the transactions (i.e. under the pay per view and subscription agreement model) were similar, their content remained the same (i.e. books, journals and articles in electronic format). Under both the transactions all the rights, title and interest in the subscribed products remained with the taxpayer (and its suppliers), as no proprietary or exclusive rights were transferred to the Indian subscribers / customers.

    Several restrictions were placed on the subscribers / customers in relation to the product purchased or subscribed so as to ensure that they cannot venture into the business of distribution of the data downloaded by it or providing its access to others.

    Both the transactions in essence were similar to purchase of a book, journal or an article in an electronic format which did not amount to use of copyright. It could, at best, be termed as use of a copyrighted article. Reliance was placed on earlier advance rulings[2] in this regard.
  - Further, when copies of the journal were stored either in physical or e-format or copies were taken for business use (such as by the lawyers, Chartered Accountants or other professionals), no use or right to use was exploited.
  - In classifying payments as 'royalty' for information concerning industrial, commercial or scientific experience, Article 12(4) of the Tax Treaty alluded to the concept of know-how.

    The taxpayer was not sharing its own experience, techniques, or methodology involving the database with its customers. The information or data transmitted through the database was published information already available in public domain and not something which was exclusively available with the taxpayer owing to its past experience. The information available on taxpayer's portal was publicly available to one and all.

    Reliance was placed on an earlier case[3] of the Mumbai Bench of the Income-tax Appellate Tribunal, wherein it was held that subscription fee received from Indian subscribers did not

[2] Dun & Bradstreet Espana, S.A., In re [2005] 272 ITR 99 (AAR) and Factset Research Systems Inc., In re [2009] 317 ITR 169 (AAR)

[3] American Chemical Society v. DCIT [2019] 106 taxmann.com 253 (Mumbai ITAT)

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amount to payment for information concerning commercial experience and hence, could not be treated as royalty under India-USA tax treaty.

Thus, the receipts from Indian subscribers in the present case was not for information concerning scientific experience under Article 12(4) of the Tax Treaty and was business income.

Thus, the receipts from Indian subscribers / customers for e-books, e-journals, e-articles was not taxable as royalty under Article 12(4) of the Tax Treaty. The receipts were in the nature of business income and since the taxpayer had no PE in India, the receipts were not taxable under the Tax Treaty.

Certain relevant provisions in brief:

- As per Explanation 2 to Section 9(1)(vi) of the ITA, "Royalty" is defined as the consideration (including lump sum payment) for the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula, process, trademark, copyright, literary, artistic or scientific work.
- Article 12(4) of India-Netherlands tax treaty (relating to taxation of royalty and fees for technical services) states that royalty means payment of any kind received for the use of, or the right to use and copyright of literary, artistic or scientific wok including cinematograph films, any patent, trade mark, design, model, plan secret formula or process, or for information concerning industrial, commercial or scientific experience.

Decision of the AAR:

Taxability of receipt as 'business income' and not 'Royalty'

- The AAR noted that the definition of royalty under Article 12(4) of the Tax Treaty was divided into the following three limbs (and that only the first and third limbs were relevant for the case under consideration):

  Payment of any kind received as a consideration for the use of, or the right to use:

  I. Any copyright of literary, artistic or scientific work;
  II. Cinematograph films, any patent, trademark, design, model, plan secret formula or process;
  III. For Information concerning industrial, commercial or scientific experience
- Consideration whether for use of, or the right to use any copyright

  The AAR dismissed the Revenue authority's contention that giving access / printing the electronic copy of content database amounted to use of copyright in a scientific work on the following basis:

  – The transaction of purchasing books/articles/journals or pay per view transactions were akin to buying books from a bookstore, as the taxpayer had granted non-exclusive, non-transferable and restricted rights, permitting subscribed products for self-use and non-commercial purpose.

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- Printing copies of content by a user for self-use was not infringement of copyright in scientific work. The action was similar to taking photocopies of contents of physical book for self-use.

  Thus, the case of the taxpayer did not fall under first limb of the definition of royalty under Article 12(4) of the Tax Treaty.

- Consideration whether for Information concerning industrial, commercial or scientific experience
  - The AAR observed that it was scientific experience of the recipient (of consideration) and not the scientific experience contained in the goods or services transferred by the payee that was to be considered.
  - In the case under consideration, the taxpayer was compiling and collating books, articles, journals relating to science, but the taxpayer was not transferring any scientific experience to the subscribers/customers.
  - As per the Organisation for Economic Co-operation and Development (OECD) commentary the words 'scientific experience' were to be construed as non-copyrighted know-how and India had not made any observation or reservation on the said paragraphs of the OECD commentary. However, on positions on Article 12 of the commentary (pg. 487) at paragraph 18, India disagreed with the interpretation that information concerning industrial, commercial or scientific experience was confined only to previous experience.

  In view of the above the AAR held that there was no transfer of any knowhow or previous or new experience to the subscribers / customers. Hence, the third limb of the definition of royalty also did not apply to the taxpayer.

The AAR observed that the case laws[4] relating to web-based sharing of publicly available compiled and collated information on non-exclusive basis were decided in favour of the taxpayer.

In view of the above, the AAR thus concluded that the receipt by the taxpayer from the Indian subscribers and customers for e-books / e-journals / e-articles was not taxably as 'royalty' as per Article 12 of the Tax Treaty but was in the nature of business income.

Existence of PE in India

The AAR stated that the determination of existence of PE in India was a factual exercise varying from year to year. Accordingly, the AAR remitted the matter back to the office of the Assessing Officer to determine as to whether the taxpayer constituted a PE in India.

Withholding tax obligation

Considering that the receipt was not chargeable to tax under section 9(1)(i) of the ITA, the AAR held that there was no requirement of withholding tax under section 195 of the ITA.

[4] ElsevierInformation Systems GmbH v. Dy. CIT(IT) [2019] 106 taxmann.com 401 (Mumbai ITAT) and American Chemical Society v. DCIT [2019] 106 taxmann.com 253 (Mumbai ITAT)

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Conclusion of the AAR

Based on the above and on the facts of the case, the AAR answered the questions raised by the taxpayer as under:

- The receipt from Indian subscribers/customers for e-books/e-journals/e-articles is not taxable as royalty as per Article 12 of the Tax Treaty but as business income.
- The AO may ascertain whether the taxpayer constituted a PE in India.
- The Indian subscribers were not required to withhold tax under section 195 of the ITA.

Comment:

This ruling affirms the principle that consideration received for providing access to the electronic copy of content database viz. e-books / e-journals / e-articles doesn't constitute royalty under Article 12(4) of the Tax Treaty but is business income.

Taxpayers may want to evaluate the impact of this ruling to the facts of their cases. It may be pertinent to note that an advance ruling is binding only on the applicant and the tax authorities in respect of the relevant transaction. It only has a persuasive value in the case of other taxpayers.

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