



Subscription payment for access to database located abroad is not taxable as royalty

Recently, the Authority for Advance Rulings (AAR) held in the matter of FactSet Research Systems Inc¹. that the subscription fee received from customers is not taxable in India as royalty. It is liable to tax as business income only if a PE exists and since the PE does not exist, the income is not subject to tax in India. Further the customers are not required to deduct tax on the payment of subscription fee.

Facts of the case

- The taxpayer is a body corporate incorporated in USA. The taxpayer maintains a database, which is located outside India and which contains the financial and economic information, including fundamental data of a large number of companies worldwide. The database contains the published information collated, stored, displayed in an organised manner.
- The salient features of the database are:
 - The information contained in the database is public in nature and the taxpayer, through the database, enables a customer to retrieve the publicly available information within shorter spans of time and in a focused manner.
 - The customers can subscribe to specific database depending on their business requirements.
 - The database maintains historical information and all the servers, database and enabling software are maintained at the datacenters in USA by the taxpayer.

¹ FactSet Research Systems Inc. (AAR no. 787 of 2008, dated 7 July 2009)

- A customer who has a requirement to use the data can view the data on their computer screens and the taxpayer allows the data to be viewed and used in reports and internal documents of its customers.
- The taxpayer's customers are financial intermediaries and investment banks. The taxpayer provides access to its database to the customers globally (including customers based in India) and receives subscription fees in this regard. The taxpayer enters into a Master Client License Agreement (MCLA) with its customers.
- Some of the key terms of MCLA are given below:
 - The taxpayer provides limited, non exclusive, non transferable rights in connection with the database.
 - The customers can use the data from accessing the taxpayer's databases solely and exclusively for their internal use and for business purposes only.
 - The taxpayer has the right to immediately terminate customer's access at any time during the term of the arrangement.
 - Customers may use the taxpayer's name for the limited purpose of source attribution of data got from the database and used in any internal/ business reports, materials or presentations.
 - The development, compilation, preparation and arrangement of the database is carried out by the taxpayer using various methods and standards developed through substantial time, effort and money and hence, it constitutes a valuable intellectual property and trade secret of the taxpayer. The customer agrees to protect the propriety rights of the taxpayer in the software and databases.

Contentions of the taxpayer

Taxability under the Act

- The taxpayer only provides mere right to view information, access or use of the database to the subscribers when they were online. Thus, there is no transfer (including license) of any right in respect of copyright is extended.
- The MCLA does not provide any right to their customers to copy, transfer, distribute, reproduce, reverse engineer etc. from or make any part of the database(s), including data received from the database(s), available to others.
- Hence, allowing a subscriber to have online rights to view, access or use the database is not covered under the definition of royalty under explanation 2 to section 9(1)(vi) of the Income-tax Act, 1961 (the

Act). Accordingly, the payment received by the taxpayer will not be taxable under the provisions of the Act.

Taxability under the India-US tax treaty (the tax treaty)

- Under the tax treaty, for a payment to fall within the ambit of 'royalty' the essential element is that the consideration should be for the use of, or the right to use, any copyright of a literary work. Thus, the tax treaty covers only 'use' of or the right to 'use' the copyright. The taxpayer does not provide any such use or right to use the copyright.
- As per article 12 of the tax treaty, 'use' signifies the exploitation of the copyright. Therefore, the rights of a temporary nature (e.g., a right to view, access or use a product while online, which may be copyrighted) would not fall within the ambit of article 12(3) of the tax treaty and accordingly, payments for such rights will not be taxable as royalties under the tax treaty..

Contentions of the tax department

- The tax department contended that the payment falls within the ambit of more than one limb of explanation 2 to section 9(1)(vi) of the Act.
- A database is a literary work under the Copyright Act and the granting of a license of a copyright would be covered by the definition of royalty. Since the MCLA refers to granting of a license to the customer for use of the database, payment received for the same will be subject to tax as royalty income.
- The customers have a right to rearrange the data according to their individual needs and therefore such rearrangement amounts to adaptation. Payments for adaptation of a literary work would be covered as royalty.
- The payment also relate to the imparting of information concerning technical, industrial, commercial or scientific knowledge, experience or skill. The payment also relates to the use or the right to use industrial, commercial or scientific equipment and would be taxable as equipment royalty.
- Additionally the tax authorities contended that the taxpayer could have an Agency Permanent Establishment (PE) in India. Therefore, the income attributable to the Agency PE would be taxable as business income.

Ruling of the AAR

Meaning of the term 'Copyright'

- The AAR observes that in order to determine a term that is undefined under the taxation law, the definition should be sought

from the law governing the subject matter. This would be all the more relevant when there is no basic difference between the statutory definition and the ordinary meaning of the term. Accordingly, the term copyright should be construed as per the provisions of the Copyright Act.

- The AAR also observes that computer database, by an amendment to the Copyright Act, falls within the ambit of literary work.
- The taxpayer collates information and arranges them in an easy to view format. The taxpayer uses its effort, experience and expertise to present the data in a focused manner. Making this centralised data available to the customer does not mean that the copyright in the database is being parted in favor of the customer.

Granting of a license

- The term granting of a license used in brackets takes the colour from the preceding expression 'transfer of all or any rights'. The term 'license' used in the MCLA is not used in the sense of mere permission to do a certain thing and does not denude the taxpayer of the copyright to the database. The term 'license' used in section 9(1)(vi) of the Act refers to an entitlement attached to a copyright so as to enable the licensee to commercially exploit the limited rights conferred on him.

Adaptation

- The adaptation contemplated by the Copyright Act will not be attracted by a mere ability to view and rearrange data according to individual customer needs.

Imparting of information

- The AAR observes that the Act and the tax treaty both refers to the 'information concerning industrial, commercial or scientific knowledge or experience'. The clause does not imply mere imparting of such knowledge or experience. The taxpayer does not share its experiences, techniques or methodology employed in evolving the database with the subscribers.
- The information that is available in public domain is collated and presented in a proper form by applying the taxpayer's methodology. This does not amount to imparting of information concerning the taxpayer's experiences, techniques or methodology employed in evolving the database with the subscribers.

Under the tax treaty

- The right that a customer obtains on payment of subscription fees does not involve the transfer of the underlying copyright. The customer is not enabled to reproduce and distribute the database to

its customers. The customer is also not enabled to exhibit the contents of the database nor can it alter or adapt the 'work'.

- Accordingly, the AAR held that same cannot fall within the meaning of royalty under the tax treaty.
- The AAR, in this context, also refers to the OECD Commentary on 'treaty characterisation issues arising from E-commerce' to indicate that the Data retrieval or delivery of exclusive or other high-value data will be taxable as business profits and not as royalty or technical fee.
- The AAR placed reliance on its earlier judgment in the case of Dun & Bradstreet Espana, S.A.² and the Bangalore Bench of Income tax Appellate Tribunal rulings in the case of Wipro Ltd.³ and Sonata Software⁴.

Accordingly, the AAR held that the subscription fee received from customers is not taxable in India as royalty. It is liable to tax as business income only if a PE exists and since the PE does not exist, the income is not subject to tax in India. Further the customers are not required to deduct tax on the payment of subscription fee.

Our comments

- The AAR recognised that employing various techniques, methodologies and using experience to create a database can be a propriety right over which the creator enjoys copyright protection.
- The AAR gave consideration to commentaries of independent authors and bodies which provided guidance on taxation of certain transactions in the international context.
- The terms used in a tax treaty should not be given widest import possible to bring to tax that which was not intended unless the context otherwise requires.

Disclaimer

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² Dun & Bradstreet Espana, S.A. in re [2004] 272 ITR 99 (AAR)

³ Wipro Ltd. v. ITO [2005] 94 ITD 9 (Bang)

⁴ Sonata Technologies Ltd. v. Addl CIT [2006] 103 ITD 324 (Bang)

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