

CBDT Notification on tax withholding from software payments

Introduction

This tax alert summarizes the notification No 21/2012 dated 13-6-2012 issued by Central Board of Direct Taxes (CBDT) for relaxation of taxwithholding from payment for computer softwares¹ pursuant to section 194J of the Income Tax Act, 1961 (ITA).

Effective date

The notification shall come in to force from the 1st day of July, 2012.

¹ Defined as written programs or procedures or rules and associated documentation pertaining to the operation of a computer system and that are stored in read/write memory

Background

Under section 194J of ITA any person (other than an individual or HUF)² is required to withhold tax at the rate of 10% from payment to any resident any sum by way of fees for professional or technical services. By an amendment with effect from 13 July 2006 the scope of the section was extended to the payment by way of royalty.

Whether any payment for purchase of computer software, is a payment of royalty or not, has been the subject matter of debate fueled by catena of judicial

² An individual or HUF is liable to withhold tax if in the immediately preceding financial year its turnover or receipts as the case may be exceed the threshold prescribed u/s 44AB of the Act.

precedents, divided in opinions, the majority view that the software license which permit download on any medium is the purchase of a 'copyrighted article' distinguished from the purchase of 'copyright' itself; payment for purchase of the former is not a royalty.

By Finance Act, 2012 the ITA has been amended with restospective effect from 1 June 1976 to clarify that payment for purchase of the software, regardless of the nature of rights in the software or the medium through which it is transferred, shall be the payment of royalty.

Distribution of the software by the original developer may involve multiple links in the supply chain before the software is acquired by the end user. If the tax is withheld @ 10% pursuant to section 194J, at each stage of distribution, substantial amount would be blocked due to multiple tax withholding. Hence, to relieve the tax payers from cascading effect of such tax withholding, CBDT has issued the notification, the contents of which are discussed here under

Contents of the Notification

No deduction of tax shall be made on following specified payment under section 194J of the Act, namely:-

Payment by a person (hereafter referred to as the transferee) for acquisition of software from another person, being a

resident, (hereafter referred to as the transferor), subject to conditions that:

- (i) the software is acquired in a subsequent transfer and the transferor has transferred the software without any modification,
- (ii) tax has been deducted-
 - (a) under section 194J on payment for any previous transfer of such software; or
 - (b) under section 195 on payment for any previous transfer of such software from a non-resident, and
- (iii) the transferee obtains a declaration from the transferor that the tax has been deducted either under sub-clause (a) or (b) of clause (ii) along with the Permanent Account Number of the transferor

Analysis

- The transferor of the software should be 'Resident' of India i.e. benefit of the notification is not available on purchase of the software by way of, import or otherwise, if the transferor is a non resident
- The software acquired under the first transfer i.e. the transfer from the original developer of the software shall not be eligible for benefit of the notification
- The subsequent transfer through a chain of dealers will be eligible for the benefit of the notification if:
 - transferor has transferred the software without any modification. If transferor has customized the software under transferee's

instructions, the benefit of the notification would not be available

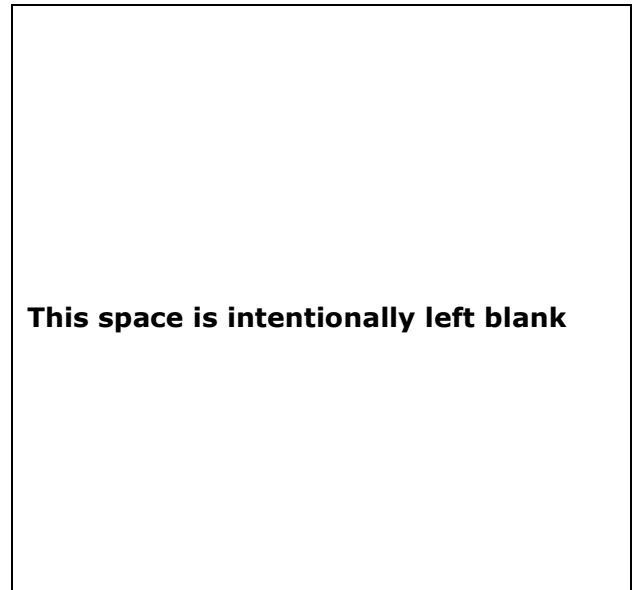
- tax has been deducted under section 194J or section 195 of the Act in any previous transfer
- The transferee obtains a declaration from the transferor that tax has been deducted as aforesaid, alongwith Permanent Account number of the transferor

Our Comments

- Tax withholding obligation u/s 194J is attracted at the time of credit to the account of the payee or at the time of payment to him, whichever is earlier. Hence, the benefit of the notification will not be available to the softwares purchased before 1 July 2012, though the payment in respect thereof may be made after the aforesaid date.

- As mentioned under background of the alert, the amendment to the ITA is retrospective w.e.f. 1 June 1976. The benefit of the notification is available to the software purchased on or after 1 July 2012. On the other hand, by issue of the notification, CBDT appears to have taken a position that every transfer (including resale) of the software prior to the date of the notification was liable to tax withholding u/s 194J of the Act. Thus, in respect of any software purchaser whose tax assessment for any assessment year is not complete on 1 April 2012, will be exposed to disallowance of the software expenses on the ground of non tax withholding. Further, the tax department can proceed against such purchaser for default in complying with

tax withholding in respect of an assessment year, whether or not his tax assessment u/s 143(3) has been completed. The direction given by the CBDT in its communication dated 29 May 2012 that the completed assessments shall not be reopened on account of retrospective amendment, does not protect tax payers against tax withholding default.



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At your Service

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