



news flash

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Tax Relief to Software Industry

New Notification

The Indian Government has issued a notification on 13 June 2012 (“**Notification**”), pursuant to which tax will no longer be deducted on multi-level software payments made to a resident, subject to certain conditions discussed below. The new provision will come into force from 1 July 2012.

Background & Budget 2012

The Indian tax laws, until recently, were capable of varying interpretations on characterization of income from software payments in view of the conflicting decisions of the various courts on whether or not payment for use of software is royalty.

The Finance Act, 2012 clarified the above issues by inserting explanations to section 9(i)(vi) of the Income Tax Act, 1961 (“**IT Act**”) with retrospective effect from June 1, 1976 stating that the consideration for use or right to use of computer software is royalty.

Although, the Finance Act, 2012 cleared the ambiguities surrounding the characterization of software payments, under the extant provisions, withholding tax on royalty payments is applicable at the rate of 10% without any exceptions. In case of multi level software distribution, this would mean that the withholding tax would be applicable at every level of the software distribution chain for e.g from a non-resident software owner to a resident distributor, from a resident distributor to the resident retailer and finally to the end consumer, resulting in multi-level taxation on such payments.

The Government has pursuant to the powers given under section 197A (IF) notified that tax is not required to be deducted at each level for acquisition of software if the stipulated conditions are complied with.

Conditions stipulated in the Notification

As per the Notification, no deduction of tax need to be made on the following specified payment under section 194J of the Act, namely:-

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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), where-

- (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 (withholding tax on payment of royalty to a resident) on payment for any previous transfer of such software; or
 - (b) under section 195 (withholding tax on taxable payment to a non resident) 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.

Effect of the Notification

As a result of the Notification, the Government has provided relief to a number of domestic tax payers in the software industry by doing away with the multi-level domestic withholding tax on software payments.

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