

**TAXATION OF ROYALTY PAYMENTS IN INDIA**

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**Introduction**

Taxation of royalty has been a much debated subject in India. If an Indian company imports concept designs and drawings from a company incorporated in another country, e.g., the UK, various questions arise about the taxation of the payment for such designs and drawings. Is such a payment in the nature of a royalty payment, thereby subjecting it to withholding tax, or is it a payment for an outright purchase of the designs and drawings! The answer to this depends on the scope of the term “royalty.”

**Definition of “Royalty”**

Black’s Law Dictionary defines “[r]oyalty” as “compensation for the use of property, usually copyrighted material or natural resource, expressed as a percentage of receipts from using the property or as an account per unit produced . . . .” As generally understood, royalty is most often associated with the fee paid to a patentee for the use of a patent or the money owed to an author for each copy of a book sold. A Texas court has ruled that royalty is the share of a product or a profit reserved by the owner for permitting another to use the property. (*Alamo Nat. Bank of San Antonio v. Hurd, Tex. Civ. App.*, 485 S. W. Zd. 335, 338) Thus, the salient feature of a royalty payment is that it is given as a compensation for the use of some property.

India’s Income-tax Act, 1961 (the “Act”) defines “royalty” to mean any consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head “Capital Gains”) for –

- (i) 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 or similar property;

- (ii) the imparting of any information concerning the working of, or the use of a patent, invention, model, design, secret formula, process, trade mark or similar property;
- (iii) the use of a patent, invention, model, design, secret formula, process, trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) the use or right to use any industrial, commercial or scientific equipment, not including the amounts referred to in section 44BB;
- (vi) the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vii) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v). (Explanation 2 to Section 9(1)(vi) of the Act)

Income from royalty is taxable in India under the Act. However, when designs are imported by an Indian company from a foreign company, it becomes pertinent to ascertain the definition of royalty given in the double taxation avoidance agreement (“DTAA”), if any, that India may have with that foreign country. For example, in the India-UK DTAA, a royalty payment is a payment of any kind for the use of, or the right to use:

- (a) any patent, trademark, design or model, plan, secret formula or process;
- (b) industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience;
- (c) any copyright of literary, artistic or scientific work, cinematographic films, and films or tapes for radio or television broadcasting. (Article 13(3) of the DTAA)

As can be seen from the foregoing, royalty has been defined differently under the Act and the India-UK DTAA. It has been held that while determining the liability of a non-resident company in India, if there is any DTAA entered into under section 90 of the Act, the provisions of the DTAA must prevail over the provisions of the Act. (*CIT v. Visakhapatnam Port Trust* [1983] 144 ITR 146)

### **Does payment for any information constitute a royalty payment!**

To determine the exact nature of the payment made, the type of information passed on needs to be verified. Payments made for all kinds of information given cannot be broadly classified as royalties. In a recent case, an Indian company paid a certain amount to a US firm to obtain information concerning certain technical knowledge of the US company. In this regard, the Madras High Court held that payments made to obtain mere data or a calculation sheet could not be treated as royalty payments. In order to withhold tax on payments for information received, the information should have some special features and should not merely be of a pure commercial nature. (*CIT v. HEG India*, 130 Taxman 72)

### **Purchase of Property v. Right to Use Property**

The Calcutta High Court has ruled that sale of know-how cannot be taxed as royalty. (*CIT v. Davy Ashmore India*, 190 ITR 626) In this case, the non-resident company did not retain any property in the designs and drawings, and the designs and drawings had been imported under India's import policy after obtaining the prior approval of the Reserve Bank of India. A royalty payment must be in respect of a right to use designs and drawings, and not for the purchase thereof. (*Pro-Quip Incorporation v. CIT* (255 ITR 354)

Under the India-USA DTAA, payments for alienation/transfer of property would be taxable as royalty only if the payments were contingent on the use or disposition of the property.

### **Can a one-time payment constitute a royalty payment!**

A one-time payment for the grant of right to use the property can be classified as royalty. The Gujarat High Court has held that a royalty may well be a single payment covering the whole use of the patent for the whole term, even though the usual practice is to make periodic payments and to relate the amounts of those payments to the actual use of the patent by the licensee. (*CIT v. Ahmedabad*

*Manufacturing and Calico Printing Co.* [1983] 139 ITR 806) Therefore, a one-time payment or payments on an ongoing basis may be characterized as royalty, provided that the payment(s) is made for the right to use the property.

### **Conclusion**

In the light of the above judgments, various points need to be examined before concluding that a payment is actually a royalty payment. If there is an outright purchase with no interest remaining in the seller company, the payment cannot be classified as royalty. Further, if the right to use certain information is acquired, the payment can only be considered as royalty if the information has some special features, expertise or skills. Additionally, payment for information regarding industry or commercial transactions cannot be treated as a royalty payment.