

E-Commerce in India

Legal, Tax and Regulatory Analysis

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1. Introduction

Today e-commerce has become an integral part of everyday life. Accessibility to e-commerce platforms is not a privilege but rather a necessity for most people, particularly in the urban areas. There are alternative e-commerce platforms available (instead of the traditional physical platforms) for almost every aspect of our lives, starting from purchasing of everyday household items to online brokerage. Mail order or catalogue shopping has been in existence in the United States since 1980. This was the predecessor of online commerce, which started in India post 2000.¹

Today the number of internet users in the world is close to 3 billion.² Out of this, India has a total of 259.14 Million internet and broadband subscribers.³ This penetration of internet coupled with the increasing confidence of the internet users to purchase online, has led to an enormous growth in the e-commerce space, with an increasing number of customers registering on e-commerce websites and purchasing products through the use of mobile phones.⁴ It is not surprising, therefore, that India is in a prime position for the growth and development of the e-commerce sector. In particular, e-commerce presents one of the greatest opportunities in the retail sector since it provides a dramatic change from brick and mortar establishments to virtual shops which could operate for a fraction of the cost.

According to a report provided by Forrester⁵ Research, social networks play an important role in driving consumers online and getting them to engage with brands. This would gain specific significance in light of facts such as India being ranked as Facebook's second largest audience after the US.⁶ However, it should be kept in mind that there still exists a form of 'digital divide' in India where the benefits of internet have not fully percolated to non-urban areas. In this scenario, mobile connections would play a very important role. India has close to 914.92

Million wireless subscribers.⁷ Mobile phones have been and will be a key tool in helping users connect in a market where overall internet penetration may be low.

The Indian Government has approved projects for providing broadband connectivity to the local and village level government bodies (i.e. the Gram Panchayats). The Government's plan is to enable broadband connectivity at the rural levels.⁸ This is further likely to boost e-commerce in India.

I. What is E-commerce

Though there exists no standard definition for the term e-commerce⁹, it is generally used in the sense of denoting a **method of conducting business through electronic means** rather than through conventional physical means. Such electronic means include 'click & buy' methods using computers as well as 'm-commerce' which make use of various mobile devices or smart phones. This term takes into account not just the act of purchasing goods and / or availing services through an online platform but also all other activities which are associated with any transaction such as:

- Delivery,
- Payment facilitation,
- Supply chain and service management.

E-commerce has defied the traditional structure of businesses trading with consumers bringing to the fore various business models which has empowered consumers.

Some of the common business models which are facilitated by e-commerce are as follows:

1. Cited from "Going back to brick and mortar", Venkatesh Ganesh available at <http://www.thehindubusinessline.com/features/weekend-life/article3836141.ece> (last visited on January 22, 2015)

2. Cited from "Internet Usage Statistics - The Internet Big Picture - World Internet Users and Population Stats" available at <http://www.internetworld-stats.com/stats.htm> (last visited on January 22, 2015)

3. Cited from "The Indian Telecom Services Performance Indicators (April – June 2014)" available at <http://www.trai.gov.in/WriteReadData/PIRReport/Documents/Indicator%20Reports%20-%20Jun-14.pdf> (last visited on January 22, 2015)

4. <http://blogs.wsj.com/indiarealtime/2014/10/15/mobile-shopping-set-to-dominate-indias-e-commerce-market/> (last visited on January 22, 2015).

5. "Trends In India's e-Commerce Market": Report provided by Forrester Research for ASSOCAM's 2nd National Conference on e-Commerce 2012.

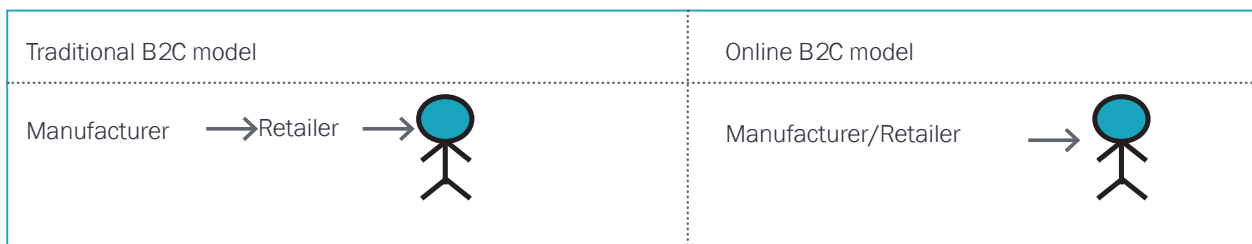
6. <http://www.statista.com/statistics/268136/top-15-countries-based-on-number-of-facebook-users/> (last visited on January 22, 2015)

7. Cited from "The Indian Telecom Services Performance Indicators (April – June 2014)" available at <http://www.trai.gov.in/WriteReadData/PIRReport/Documents/Indicator%20Reports%20-%20Jun-14.pdf> (last visited on January 22, 2015)

8. <http://www.dot.gov.in/reports-statistics/12th-five-year-plan> (last visited on January 22, 2015)

9. In Chapter III, we have discussed how the FDI Policy categorises e-commerce activities. However this categorization is relevant from the point of view of foreign investments which we have dealt with in Chapter III.

- B2B:** E-commerce has enabled various businesses to build new relationships with other businesses for efficiently managing several of their business functions. B2B e-commerce could comprise of various models, which may include distribution services, procurement services, digital / online market place like services etc. IndiaMART.com is one such B2B online market place which provides a platform for businesses to find other competitive suppliers. On the other hand Ariba provides procurement services by providing access to digital electronic market.
- B2C:** Direct dealings between businesses and consumers have always existed; however with the emergence of e-commerce such transactions have gained further momentum. In a traditional B2C model, the distribution channel typically starts with manufacturer and goes through a distributor / wholesaler to retailer, who interacts with the end customer. However, in an online model one finds the manufacturer or the intermediary directly trading with the consumer.



Most sellers of products or services in the physical medium have begun providing their goods/ services on the internet as well and it is by virtue of this model that e-tailing has become very popular with internet users where a near virtual shop is created with images of products sold. This not only provides cost benefits to the sellers as brick and mortar type of investments are considerably reduced, but the seller is also able to provide benefits to the consumers in terms of discounts and free additions (such as free delivery)

- C2C:** Traditionally consumers have had dealings with other consumers, but only few of those activities were in a commercial sense. E-commerce has made it possible to bring together strangers and providing a platform for them to trade on. For example, portals such as eBay and quikr enables consumers to transact with other consumers.
- C2B:** This relatively new model of commerce and is a reverse of the traditional commerce models; here consumers (i.e. individuals) provide services/ goods to businesses and create value for the business. This type of transaction can be seen in internet forums where consumers provide product development ideas or in online platforms where consumers provide product reviews which are then used for advertisement purposes.
- B2B2C:** A variant of the B2C model wherein there is an additional intermediary business to assist the first business transact with the end consumer. This model is poised to do much better

in a web based commerce with the reduced costs of having an intermediary. For instance, Flipkart, one the most successful e-commerce portals provides a platform for consumers to purchase a wide variety of goods such as, electronic goods, apparels, books and music CDs. In fact the growth of this model is evident from the surge in the number of e-commerce players adopting this model in recent times – fashionandyou, Jabong to name a few. Further, apart from businesses providing intermediary services such as that of Flipkart a lot of online platforms tie up with payment gateway facilitators who provide a platform for the processing of payments.

Though at the outset, the prospect of conducting business through e-commerce may seem uncomplicated and economical, there are a variety of legal factors that an e-commerce business must seriously consider and keep in mind before commencing and while carrying out its activities. The importance of dealing with these complex legal issues have already been highlighted starting from the court ruling in the year 2001 in the “Napster.com” case wherein the United States Ninth Circuit Court of Appeals held that music filesharing system known as “Napster” committed repeated infringements of copyright law as millions of users uploaded and downloaded copyright protected sound recordings. Closer home, the Delhi High Court held in the ‘Myspace’ order that social networking sites such as Myspace may be held liable for copyright infringement caused due to infringing material posted on such if the intermediaries had control over the material posted, had the opportunity to exercise

due diligence in preventing infringement and derived profits out of such infringing activities. Further, privacy and data protection issues have assumed great significance with the Indian Government notifying specific rules for data protection.

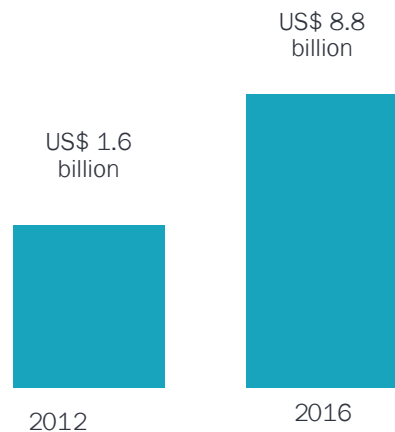
In this paper we shall discuss some of the important legal issues relating to e-commerce in India.

2. Snapshot of E-Commerce Industry in India

A report by the Internet and Mobile Association of India has revealed that India's e-commerce market expected to grow by 37% to reach USD 20 Billion by 2015.¹⁰

According to a report provided by Forrester¹¹ Research, e-commerce revenues in India will increase by more than five times by 2016, jumping from USD 1.6 billion in 2012 to USD 8.8 billion in 2016.

Figure 1 forecast: India Online Retail Revenues (B2C & C2C), 2012 & 2016



Source: Forrester Research Online Retail Forecast, 2011 To 2016 (Asia Pacific)

78361

Source: Forrester Research, Inc.

According to report provided by Forrester¹² Research, shoppers in metropolitan India are driving e-commerce: these consumers primarily avail of e-commerce service in the areas of travel, consumer electronics and online books.

I. Penetration of E-commerce Model – An Industry wise Analysis

The growth of the e-commerce industry over the last few years is definitely undisputable, at the same time it is important to understand that success stories of e-commerce as a model have been observed in certain specific industries. According to recent news reports¹³, **the travel industry accounts for nearly three-fourths of the commerce that takes place online**

(approximately 71 % and e-tailing taking the second spot with a small share of 16%.

In fact e-commerce has radically changed the travel industry to the extent that making travel plans is just a click away as is evident from the increasing number of users of IRCTC i.e. the website for booking tickets for Indian Railways. Even though the surge in the use of e-commerce was primarily with respect to booking tickets online, now, even related activities such as hotel accommodation and car rental are also catching on.

The fact that only a small market share is attributable to the e-tailing industry does not defy the growing influence that online shopping has on people. In recent times, e-tail businesses are adopting various technologies to create a near virtual world to overcome the biggest hurdle that e-tailing faces, namely, the direct connection that the customer has

10. <http://www.livemint.com/Industry/ZH8rVd65WLhQzsUFYE9zCJ/Indian-ecommerce-market-to-reach-20-billion-next-year-rep.html> (last visited on January 22, 2015)

11. 'Trends In India's e-Commerce Market': Report provided by Forrester Research for ASSOCAM's 2nd National Conference on e-Commerce 2012.

12. 'Trends In India's e-Commerce Market': Report provided by Forrester Research for ASSOCAM's 2nd National Conference on e-Commerce 2012.

13. <http://www.livemint.com/Industry/ZH8rVd65WLhQzsUFYE9zCJ/Indian-ecommerce-market-to-reach-20-billion-next-year-rep.html> (last visited on January 22, 2015)

with the goods.¹⁴ In the initial years e-tailing seemed more popular for purchase of computer products and it still does contribute to a majority of e-tailing, but lifestyle shopping seems to be the new found trend for internet users. These businesses have capitalized on the convenience factor that online trading offers to customers and this has been the success mantra not just for Flipkart but host of other websites.

Financial services have also seen a sizeable growth in the use of e-commerce model. This sector which did not have much of share in the e-commerce industry in 2008 is now pretty much on par with e-tail businesses in its share of the e-commerce industry.

14. Cited from Using tech to make e-tail as real as retail, Pragya Singh, DNA, September 26, 2012 and available at http://www.dnaindia.com/analysis/column_using-tech-to-make-e-tail-as-real-as-retail_1745323 (last visited on January 22, 2015)

3. Investments in the E-Commerce Space in India

Foreign direct investment (“FDI”) in India is regulated under the Foreign Exchange Management Act 1999 (“FEMA”). The Department of Industrial Policy and Promotion (“DIPP”), Ministry of Commerce and Industry, Government of India makes policy pronouncements on FDI through Press Notes and Press Releases which are notified by the Reserve Bank of India (“RBI”) as amendments to Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000.

The consolidated FDI policy issued by the DIPP (“FDI Policy”) lays down two entry routes for investment:

- i. *Automatic Route where foreign investments do not require prior approval of the government and*
- ii. *Government / Approval Route where prior approval of the Government of India through Foreign Investment Promotion Board (“FIPB”) is required.*

I. What Constitutes E-commerce under the FDI Policy

The FDI Policy states as follows:

“E-commerce activities refer to the activity of buying and selling by a company through the e-commerce platform”

This definition makes it clear that any buy / sale transactions would be covered. This definition does not seem to cover other forms of transactions which could take place on e-commerce platforms such as information sharing and advance bookings (without payments being made).

II. FDI Restrictions in E-commerce

The current regulatory status with respect to foreign investments in the e-commerce space is as follows;

- 100% FDI is allowed under the automatic route (i.e. no FIPB approval is required) in companies engaged in B2B e-commerce.¹⁵
- No FDI is allowed in companies which engage in single brand retail trading by means of e-commerce.¹⁶
- No FDI is allowed in companies which engage in multi brand retail trading by means of e-commerce.¹⁷

These restrictions are related to sale of goods and not services.

There have been various liberalizations in FDI in single brand retail and multi brand retail and it was thought that FDI in e-commerce would also be liberalized. However, there continues to be restrictions in this space.

These express restrictions on FDI in B2C businesses has led to development of market place models, where the online platform acts as a trading platform rather than a trader. In this case the online platform’s clients are various sellers who own the inventory of goods and advertise their goods on the online platform. The ultimate sale of the goods is completed between the third party seller and the end consumer.

There are other innovative models which are being adopted to bring in investments into companies engaged in e-commerce or companies which directly or indirectly collaborate with e-commerce businesses such as

- Investing into companies engaged in wholesale trading (where 100% FDI is allowed under the automatic route subject to certain conditions¹⁸) which owns inventory and maintains the online B2B platform.

15. Para 6.2.16.2.1 of the Consolidated FDI Policy 2014

16. Para 6.2.16.3 of the Consolidated FDI Policy 2014

17. Para 6.2.16.4 of the Consolidated FDI Policy 2014

18. Under Para 6.2.16.1.2 of the FDI Policy 2014, some of the pertinent conditions to be fulfilled for investing into a wholesale trading company are (i) wholesale trade to group companies should not exceed 25% of the total turnover of the venture (ii) a wholesale trader cannot open retail shops to sell to the consumer directly, (iii) full records indicating all the details of the sales (such as name of entity, kind of entity, registration/ license/ permit etc, number and amount of sale) to be maintained on a daily basis.

- Investing into companies providing technology services (where 100% FDI is allowed under the automatic route) which provides technology related services on an arms length basis to e-commerce platforms.

While considering any such models, it is important to be in compliance with the FDI Policy.

III. Recent Developments

Some of the major investments that have been witnessed recently are as follows:¹⁹

- Flipkart, raised \$1 billion from Tiger Global Management and Naspers. Singapore's sovereign wealth fund, GIC, along with existing investors Accel Partners, DST Global, ICONIQ Capital, Morgan Stanley Investment Management and Sofina, also participated in this latest financing round.
- The financial service arm of the Japanese telecommunication and internet corporation, SoftBank Internet and Media, Inc. committed \$627 million funding in New Delhi-based online marketplace, Snapdeal. Following the investment, SoftBank became the biggest stakeholder in the company.
- In February 2014, Kunal Bahl-led Snapdeal amassed \$133 million funding led by eBay, Kalaari Capital, Nexus Venture Partners, Bessemer Venture Partners, Intel Capital and Saama Capital.
- Mukesh Bansal-led Myntra secured \$50 million (about Rs.300 crore) investment led by Premji Invest along with existing investors Accel Partners and Tiger Global.
- Grocery etailer Bigbasket snapped up \$33 million from Helion Ventures, Ascent Capital, Zodius Capital and Lionrock Capital in September 2014.
- Fashion e-commerce major Jabong secured \$27.5 million (Rs 173 crore) from British development finance institution CDC in a deal in February 2014.
- Furniture etailer Urbanladder closed \$21 million (approx Rs.120 crore) Series B funding from Steadview Capital along with the existing investors, SAIF Partners and Kalaari Capital, in January 2014.

19. <http://yourstory.com/2014/11/top-e-commerce-investments/> (last visited on January 22, 2015)

4. Legal Validity of Electronic Transactions

In this chapter, we discuss various legal issues relating to the formation and validity electronic transactions such as online contracts and enforcement issues.

I. Formation of an E-Contract

Some of the most common forms of e-contracts are *click wrap*, *browse wrap* and *shrink-wrap* contracts.

In each of these contracts, the terms and conditions of the contract are made available to the contracting party in a form that is significantly different from the usual paper contracts. In case of a *click wrap* contract, the contracting party's affirmative acceptance is taken by means of checking on an "I accept" tab. Also, there is typically a scroll box that allows the contracting party to view the terms and conditions. An example of how a click wrap contract would look is given below.



A *browse wrap* agreement is intended to be binding on the contracting party by the mere use (or browse) of the website.

Shrink wrap agreements though not directly relevant to e-commerce platforms are relevant in the context of e-commerce mostly because of the kind of goods associated with shrink-wrap agreements. In case of a shrink-wrap agreement the contracting party can read the terms and conditions only after opening the box within which the product (commonly a license) is packed.

II. Validity of Online Contracts

Existence of a valid contract forms the crux of any transaction including an e-commerce transaction. In India, e-contracts like all other contracts are governed by the basic principles governing contracts in India, i.e. the Indian Contract Act, 1872 ("**Indian Contract Act**") which *inter alia* mandate certain pre-requisites for a valid contract such as free consent and lawful

consideration. What needs to be examined is how these requirements of the Indian Contract Act would be fulfilled in relation to e-contracts. In this context it is important to note that the Information Technology Act, 2000 ("**IT Act**") provides fortification for the validity of e-contracts.

Some of the important requirements of a valid contract under the Indian Contract Act are as follows:

- i. The contract should be entered into with the free consent of the contracting parties;
 - ii. There should be lawful consideration for the contract;
 - iii. The parties should be competent to contract;
 - iv. The object of the contract should be lawful
-

Unless expressly prohibited under any statute, e-contracts like click-wrap agreements would be enforceable and valid if the requirements of a valid contract as per the Indian Contract Act are fulfilled. **Consequently the terms and conditions which are associated with an e-commerce platform are of utmost importance in determining and ensuring that e-commerce transactions meet with the requirements of a valid contract.**

The IT Act, however, is not applicable in relation to negotiable instruments, power of attorneys, trust, wills contracts for sale or conveyance of immovable property

A. Signature Requirements

There is no requirement under the Indian Contract Act to have written contracts physically signed. However, specific statutes do contain signature requirements. For instance the Indian Copyright Act, 1957 (“**Copyright Act**”) states that an assignment of copyright needs to be signed by the assignor. In such cases the IT Act equates electronic signature with physical signatures. An electronic signature is supposed to be issued by the competent authorities under the IT Act. However till the date of this paper, the Central Government has not notified any electronic signatures.

B. Contracts with Minors

The very nature of e-commerce is that is virtually impossible to check the age of anyone who is transacting online. This may pose problems and liabilities for e-commerce platforms. The position under Indian law is that a minor is not competent to enter into a contract and such a contract is not enforceable against the minor. The age of majority is 18 years in India.

C. Stamping Requirements

Every instrument under which rights are created or transferred needs to be stamped under the specific stamp duty legislations enacted by different states (provinces) in India. An instrument that is not appropriately stamped may not be admissible as evidence before a competent authority unless the requisite stamp duty and the prescribed penalty

have been paid. In some instances criminal liability is associated with intentional evasion of stamp duty. However, the manner of paying stamp duty as contemplated under the stamp laws is applicable in case of physical documents and is not feasible in cases of e-contracts.

III. Whether Standard-form Online Contracts are Unconscionable

In general there is little or no scope for negotiations to be held between e-commerce platforms and customers regarding the terms of the online contracts. The question then arises whether such standard form contracts are to be considered unconscionable and may be struck down by the courts.

A. Position in the US

In the US, there have been instances where the courts have struck down specific terms of contracts which were held to be unconscionable.

In the case of *Comb v. PayPal, Inc*²⁰ the California courts found that the e-commerce agreement which obligated users to arbitrate their disputes pursuant to the commercial rules of the American Arbitration Association which is cost prohibitive in light of the average size of a PayPal transaction. Accordingly, the court denied motions by PayPal to compel users who commenced putative class action suits arising out of PayPal's allegedly inappropriate handling of customer accounts and/or complaints to resolve their claims via arbitration. The court argued that the dispute resolution program of PayPal was unconscionable because *inter alia* because it mandatorily required that disputes were resolved in Santa Clara county, California, where PayPal is located and PayPal maintained possession of customer funds until any dispute is resolved.

In the case of *Bragg v. Linden Research*,²¹ the courts found that an internet site's arbitration provision could not be enforced on the basis that it was both procedurally and substantively unconscionable. In this case the plaintiff, an owner of virtual property on an Internet site, sued defendants, operators of the Internet virtual world, for the removal of certain virtual property he purchased from the virtual

20. 218 F. Supp. 2d 1165 (2002); Cited from “*Unconscionable Terms Prevent Enforceability Of E-Commerce Contract Clauses*” By Jonathan D. Bick available at <http://www.bicklaw.com/Publications/UnconscionableTermsandE-contracts.htm> (last visited on January 22, 2015)

21. 487 F. Supp. 2d 593 (2007); Cited from “*Unconscionable Terms Prevent Enforceability Of E-Commerce Contract Clauses*” By Jonathan D. Bick available at <http://www.bicklaw.com/Publications/UnconscionableTermsandE-contracts.htm> (last visited on January 22, 2015)

world and for freezing of the plaintiff's account. The defendants contended that the terms of the use agreement for the site compelled arbitration. In this matter the arbitration provision was buried in a take-it-or-leave-it set of terms presented to customers before they could participate on the site. The provision's lack of mutuality, the costs of arbitration, the forum selection clause, and the confidentiality provision demonstrated that the arbitration clause favored the site operators over the participants. Consequently, the court denied the motion to compel arbitration.

B. Position in India

In India there does not seem to be well developed jurisprudence on the issue of whether standard form online agreements are unconscionable. However, Indian laws and Indian courts have dealt with instances where terms of contracts (including standard form contracts) were negotiated between parties in unequal bargaining positions. Certain provisions under the Indian Contract Act deal with the unconscionable contracts such as when the consideration in the contract or the object of the contract is opposed to public policy. If the consideration or object of the contract is opposed to public policy, then the contract itself cannot be valid. In case of unconscionable contracts, the courts can put a burden on the person in the dominant position to prove that the contract was not induced by undue influence. The Indian Contract Act does not define the expression 'public policy' or what is meant by being 'opposed to public policy. However this section allows the court to hold clauses opposed to public policy as void.

Section 16(3) of the Contract Act provides that where a person who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

Section 23 of the Contract Act provides that the consideration or object of any agreement is unlawful when

- i. It is forbidden by law, or**
- ii. Is of such a nature that if permitted, it would defeat the provisions of any law; or**
- iii. Is fraudulent, or**
- iv. Involves or implies injury to the person or property of another, or**
- v. The Court regards it as immoral or opposed to public policy.**

In the case of *LIC India v. Consumer Education & Research Center*²² the Supreme Court interpreted an insurance policy issued by Life Insurance Corporation of India by bringing in certain elements of public purpose. The court declared certain term clauses in the policy, pertaining to restricting the benefit of the policy only to those people employed in the Government as void under article 14 of the Constitution. The Court noted that *"In dotted line contracts there would be no occasion for a weaker party to bargain as to assume to have equal bargaining power. He has either to accept or leave the service or goods in terms of the dotted line contract. His option would be either to accept the unreasonable or unfair terms or forgo the service forever"*

In the case of *Lily White v R Munuswami*²³ the court held that a limitation of liability clause printed on the back of a bill issued by a laundry which restricted the liability of the laundry to 50% of the market price of the goods in case of loss was against public policy and therefore void.

In light of the above, it is extremely important to have well thought out terms which form the online contracts and ensure that adequate opportunity is provided to the customers to familiarize themselves with the terms thereof.

22. 1995 AIR 1811.

23. AIR 1966 Mad 13

5. Security Issues in E-Commerce

In this chapter we discuss some of the pertinent security related issues that relate to e-commerce businesses in light of applicable Indian laws.

I. Authentication and Identification

Though the Internet eliminates the need for physical contact, it does not do away with the fact that any form of contract or transaction would have to be authenticated and in certain instances recorded. Different authentication technologies have evolved over a period of time for authenticating documents and also to ensure the identity of the parties entering into online transactions. Further in relation to an e-commerce business, processing payments forms a vital part of the transaction and in this regard various payment systems to carry on an e-commerce business have also developed.

Transactions on the internet, particularly consumer-related transactions, often occur between parties who have no pre-existing relationship. This may raise concerns of the person's identity and authenticity with respect to issues of the person's capacity, authority and legitimacy to enter the contract. Electronic signatures may be considered as one of the methods used to determine the authority and legitimacy of the person to authenticate an electronic record.

In fact the IT Act gives legal recognition to the authentication of any information by affixing an electronic signature as long as it is in compliance with the manner as prescribed under the IT Act. Further, the IT Act also provides the regulatory framework with respect to electronic signatures including issuance of electronic signature certificates.

In particular the IT Act provides that an electronic signature shall be deemed to be a secure electronic signature if:

- i. The signature creation data, at the time of affixing the signature, was under the exclusive control of the signatory and no other party; and

- ii. The signature creation data was stored and affixed in such exclusive manner as may be prescribed.

A. Identity Theft and Impersonation

- The IT Act provides that the identity of a person shall be deemed to have been stolen when any unique identification of a person (such as her electronic signature or password) is fraudulently or dishonestly used. The Act prescribes a penalty of imprisonment of up to 3 years and fine up to INR 1 lakh.²⁴
- The IT Act provides that whoever, by means of any communication device or computer resource cheats by impersonation, shall be punished with imprisonment of up to 3 years and with fine of up to INR 1 lakh.²⁵
- The IPC further provides that any person who cheats by impersonation shall be punishable with imprisonment of up to three years and/ or fine.²⁶

II. Privacy

For an e-commerce platform, it is almost difficult to complete any online transaction without collecting some form of personal information of the users such as details about their identity and financial information. Apart from the collection of primary data from the users, e-commerce platforms may also collect a variety of other indirect information such as users' personal choices and preferences and patterns of search.

Hence, an important consideration for every e-commerce platform is to maintain the privacy of its users. Two primary concerns that a user of e-commerce platforms would have are:

- i. Unauthorized access to personal information
- ii. Misuse of such personal information.

Historically, the concept of privacy and data protection were not addressed in any Indian legislation. In the absence of a specific legislation, the Supreme Court of India in the cases of *Kharak Singh*

24. Section 66-C of the IT Act.

25. Section 66-D of the IT Act.

26. Section 419 - Punishment for cheating by impersonation

Whoever cheats by impersonation shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both.

*v State of UP*²⁷ and *People's Union of Civil Liberties v. the Union of India*²⁸ recognised the “right to privacy” as a subset of the larger “right to life and personal liberty” under Article 21 of the Constitution of India. However a right under the Constitution can be exercised only against any government action. Non-state initiated violations of privacy may be dealt with under principles of torts such as defamation, trespass and breach of confidence as applicable.

The IT Act deals with the concept of violation of privacy in a limited sense; it provides that the privacy of a person is deemed to be violated where images of her private body areas are captured, published or transmitted without her consent in circumstances where she would have had a reasonable expectation of privacy²⁹ and prescribes a punishment of imprisonment of up to 3 years and/or fine of up to INR 2 lakhs.

III. Data Protection

India has in the year 2011 notified rules under Section 43A of the IT Act titled “*Reasonable practices and procedures and sensitive personal data or information Rules, 2011*” which provide a framework for the protection of data in India (“**Data Protection Rules**”).

A. Kinds of Information covered under the Data Protection Rules

There are basically two categories of information which are covered under the IT Act which need to be considered with respect to data protection.

- i. Personal information (“PI”) which is defined as any information that relates to a natural person, which, either directly or indirectly, in combination with other information available or likely to be available with a body corporate, is capable of identifying such person.
- ii. Sensitive personal data or information (“SPDI”) which is defined means such PI of a person which consists of
 - a. password;
 - b. financial information such as Bank account or credit card or debit card or other payment instrument details ;

- c. physical, physiological and mental health condition;
- d. sexual orientation;
- e. medical records and history;
- f. Biometric information.

The Data Protection Rules, inter alia, set out compliances which to protect SPDI in the electronic medium by a corporate entity which possess, deals with or handles such SPDI such as:

- i. The need to have a privacy policy in accordance with the parameters set out in the Data Protection Rules;
- ii. The need to obtain consent in a specific manner from the provider of SPDI;
- iii. The need to provide an opt out option to the provider of SPDI;
- iv. The need to maintain reasonable security practices and procedures in accordance with the requirements of the Data Protection Rules (discussed below).

We have previously published two write ups (Hotlines) which discuss the compliances required in respect of SPDI. You may access these at

- i. http://www.nishithdesai.com/New_Hotline/IT/Technology%20Law%20Analysis_June1811.htm
- ii. http://www.nishithdesai.com/New_Hotline/IT/IT%20Hotline_final_aug%2026.htm

B. Potential Liability under the Data Protection Rules

The IT Act prescribes penalties for aronful disclosure of PI by way of imprisonment up to three years and/ or a fine up to INR 5 lakhs. The IT Act also prescribes compensation to be awarded by companies that are negligent in the protection of SPDI of any person.

IV. Security of Systems

Security over the Internet is of immense importance to promote e-commerce. Since e-commerce companies keep sensitive information (including

27. AIR 1963 SC 1295

28. 1997 (1) SCC 318

29. Section 66-E of the IT Act

SPDI) on their servers, e-commerce companies must ensure that they have adequate security measures to safeguard their systems from any unauthorized intrusion. A company could face security threats externally as well as internally. Externally, the company could face problems from hackers, viruses and trojan horses. Internally, the company must ensure security against its technical staff and employees.

6. Payment Mechanisms For E-Commerce

The advent of new methods of conducting business, particularly electronic commerce brought about the need for new, payment systems that are both tech savvy and efficient at the same time. This has led to the phenomenal growth of electronic payment systems around the world. An electronic payment system, modelled for an e-commerce business, may sound simple – a customer chooses a product to buy online, clicks ‘pay’, enters certain credit card / bank details, and the entire transaction is complete. However, electronic payment systems are often more complex than traditional payment methods, as they typically involve a number of players:

- a payer – the customer;
- a payee – the merchant;
- an issuing bank - the customer’s bank;
- an acquiring bank - the merchant’s bank;
- entities such as Master or Visa – typically associations of banks / financial institutions, which provide an array of payment products to financial institutions;
- one or more payment processors / payment gateways - that provide technology for the receipt and processing of payment instructions and settlement, or actually receive and hold funds received from the customer for onward payment to the merchant; and
- certification authorities, such as Payment Card Industry Security Standards Council.

In this chapter we discuss some of the important aspects of payment systems and regulations surrounding such systems in India with particular emphasis on e-commerce.

I. What is a Payment System

Payment systems, both traditional and electronic in India are regulated by the Payment and Settlement Systems Act, 2007 (“PSS Act”).

The PSS Act defines a ‘payment system’ as follows:

“a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement³⁰ services or all of them but does not include a stock exchange”.

The PSS Act explains that for the purpose of the definition, “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations

The PSS Act empowers the Reserve Bank of India (“RBI”) to govern payment systems operational in the country.

In addition to the PSS Act, there may be several other rules and regulations, including those established by the RBI that govern a system that involves the ‘clearing, payment or settlement’ of a payment, depending upon the nature of service or undertaking involved.

II. Players Involved In Electronic Payment Systems

Below we look at the most important service providers / stakeholders in the ecosystem of electronic payment systems, and identify the most prominent legal issues based on the regulations governing the same.

A. Payment Processors

Payment processing functions typically involve clearing, payment and settlement, which constitutes the core functions of a payment system as per the definition under the PSS Act. These functions are highly regulated by the RBI as well as various statutes, and the PSS Act provides that only banks and financial institutions / entities that have

30. Section 2 (n) of the PSS Act defines “Settlement” as “settlement of payment instructions and includes the settlement of securities, foreign exchange or derivatives or other transactions which involve payment obligations.”

specific authorization of the RBI can undertake such activities.

B. Intermediaries

Intermediaries are defined by the RBI ³¹ as “*entities that collect monies received from customers for payment to merchants using any electronic/online payment mode, for goods and services availed by them and subsequently facilitate the transfer of these monies to the merchants in final settlement of the obligations of the paying customers*”. Keeping in mind the growth in the use of electronic payment methods across India, the RBI issued certain ‘*Directions for opening and operation of Accounts and settlement of payments for electronic payment transactions involving intermediaries*³² (“**RBI Directions on Intermediaries**”), which regulate the operations of accounts for the receipt and payment of funds by such intermediaries. Among other things, the RBI Directions on Intermediaries regulate the nature of accounts that intermediaries can operate i.e. internal accounts, the permitted credits and debits that can be made from such accounts and also provide for specific time limits within which funds must be remitted to a merchant upon receipt of funds from a customer.

C. Technology Providers

Technology providers typically provide technology or solutions to facilitate transmission of customer/merchant data, instructions, approvals, denials etc. that are comprised within a payment system. Such technology could either be in the form of software or hardware. Often we see that the payment gateways / intermediaries themselves double up and play the role of a technology provider as well. Typically technology providers are not regulated.

III. Payment Instruments

A payment instrument is any type of instrument, physical / electronic which has certain monetary value, and allows for payments equally all / part of such monetary value to be made using the instrument. Traditional payment instruments are cheques, drafts, money orders etc.

With the growth of technology, we have also seen a large growth in the types of payment instruments available for use, and in today’s technology driven world, it is key to ensure that such payment instruments allow for easy access to e-commerce transactions. Some common payment instruments which are used for e-commerce transactions are:

A. Credit / Debit cards

Although credit and debit cards are not new technology by any means, credit card use has seen a spur of growth in India over the past two decades. With increasing disposable income, and the ease of simply carrying one card that allows a user to make payments, whether at a store around the corner or an online shopping site – these cards which were once novelties, have now almost become a necessity. The issue and of both credit cards and debit cards are regulated by the RBI, and currently only banking and non-banking financial institutions are permitted to issue such cards, subject to guidelines issued by the RBI.

B. Pre – Paid Instruments

The RBI in its guidelines ³³ define pre-paid instruments as ‘*...payment instruments that facilitate purchase of goods and services, including funds transfer, against the value stored on such instruments...*’. Pre-paid instruments can include smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount. Pre-paid instruments can be of 3 types (as classified by the RBI guidelines ³⁴):

- *Closed system payment instruments* – which are issued by a person for facilitating purchase of certain specific and limited goods / services, from the issuing person only and do not permit the withdrawal of cash / redemption.
- *Semi-closed system payment instruments* – which can be used for purchase of goods and services from a group of clearly identified merchant locations/ establishments which have a specific contract with the issuer, only. Cash withdrawal / redemption is not permitted for such systems either.

31. Definition of Intermediary under RBI Notification number DPSS.CO.PD.No.1102 /02.14.08/ 2009-10, dated November 24, 2009.

32. Ibid

33. Issuance and Operation of Pre-paid Payment Instruments in India – Consolidated Revised Policy Guidelines, DPSS.CO.PD.No. 2074/02.14.006/2013-14

34. Ibid

- *Open system payment instruments* - which can be used for purchase of goods and services, including financial services like funds transfer, and can also be used for withdrawal of cash.

The RBI regulates the issue of pre-paid instruments, providing for the nature of entities that can issue such systems, capital requirements, safeguards against money laundering, the purposes for which pre-paid instruments can be issued etc.

IV. Card not Present Transactions

With both E-Commerce growing rapidly in India, an increasing number of businesses, whether service or product based, require payment online or via phone – leading to ‘Card Not Present’ (“CNP”) transactions.

A CNP transaction is one where the customer and the merchant / service provider are not physically in the same location, and the merchant does not have access to the card being used, thereby making it difficult for the merchant / service provider to verify the identity of the customer.

This could lead to situations in which payments and transactions are completed without the knowledge or authorization of the actual holder of a credit card.

Taking heed of the growing number of incidents of credit card fraud, especially via online payment portals, the RBI issued a notification in February 2009³⁵, mandating the use of an additional authentication / validation system (also referred to as 2nd level authentication / 3D verification) for online CNP transactions. The requirement for this system of additional authentication, has also extended to interactive voice response (IVR) transactions since. Further, banks are also required to put in place an online alert system which would notify the cardholder of any CNP transaction.

The additional authentication / validation is to be obtained using information that was not visible on the credit card itself, i.e. information known or available to the holder of the card but not printed on the card. One time passwords, internet banking passwords are examples of 2nd level authentication.

The requirement for 2nd level authentication is applicable to all transactions where:

- The card was issued in India; **and**

- There was no outflow of foreign exchange contemplated.

While the above measures were taken in order to provide for adequate security measures and prevent fraudulent transactions, merchants have typically not been happy with the above mentioned requirements since:

- Obtaining a second level authentication prevents merchants from implementing mechanisms where continuous / repeat payments can be made by customers, for example, in the case of subscription based services.
- Obtaining a second level authentication requires more time and effort for a customer as opposed to a simple click through transaction.
- An increase in the rate of transaction failures, as the customer’s bank may not always be able to process the authentication.

As a result, it appears that some players in the industry may have structured their businesses by receiving payments in an offshore entity – this issue recently cropped up specifically with respect to the radio taxi industry. Domestic radio taxi service providers in India, like any other domestic service providers, were required to ensure that the additional authentication requirements were met for CNP payments. However, since the authentication requirements do not apply to transactions with entities outside India, additional authentication / validation would not be required. Allegations were made that Uber, an international radio taxi provider, with operations in multiple countries, had taken advantage of this exception, by allowing customers to make payments to foreign accounts held by Uber. An association of radio taxis brought such practices to the attention of the RBI recently, and as a result, the RBI issued a directive³⁶, which clarified that *‘merchant transactions (for underlying sale of goods / services within India) being acquired by banks located overseas resulting in an outflow of foreign exchange in the settlement of these transactions is not acceptable’*, and that where cards issued by banks in India are used for making CNP payments towards purchase of goods and services provided within the country, such transactions should be settled in Indian currency and the acquisition of such transactions should also be through a bank in India.

35. RBI / DPSS No. 1501 / 02.14.003 / 2008-2009

36. DPSS.PD.CO. No.371/02.14.003/2014-2015

7. Consumer Protection Issues

In view of the new models of business in e-commerce, it is important to keep in mind consumer protection issues. In India the Consumer Protection Act 1986 (“CPA”) governs the relationship between consumers and service/goods providers. There is no separate consumer protection law that is specific to and regulates online transactions. Liability under the CPA arises when there is “deficiency in service” or “defect in goods” or occurrence of “unfair trade practice”. The CPA specifically excludes from its ambit the rendering of any service that is free of charge.

- If an online platform is not charging the users, the CPA may not apply.
- If actual sales are taking place on the online platform, the users will be considered ‘consumers’ under the CPA and its provision will apply to the sale of products by the online platform. Depending upon who is actually selling the goods or rendering services the liability may trigger. The distributor of goods also comes within the purview of the CPA.

There is a special adjudicating forum (with appellate forums) which is constituted under the CPA. Some of the various sanctions which may be imposed under the CPA are as below:

- i. Removal of defects / deficiencies
- ii. Replacement of goods
- iii. Return of price paid;
- iv. Pay compensation as may be awarded;
- v. discontinue the unfair trade practice or the restrictive trade practice or not to repeat them;

8. Intellectual Property Issues

One of the foremost considerations that any company intending to commence e-commerce activities should bear in mind is the protection of its intellectual assets. The internet is a boundless with minimum regulation and therefore the protection of intellectual property rights (“IP” or “IPR”) is a challenge and a growing concern amongst most e-businesses. While there exist laws in India that protect IPRs in the physical world, the efficacy of these laws to safeguard these rights in e-commerce is not simple. Some of the significant issues that arise with respect to protecting IPRs in e-commerce are discussed hereunder.

I. Is there a Protectable Intellectual Property?

Traditionally inventions, literary works, artistic works, designs and trademarks formed the subject matter of early intellectual property law. However with the advent of new technologies, new forms of IPRs are evolving and the challenge for any business would be in identifying the various options for protection of its intellectual assets and how best they can be protected. Some of the main forms of intellectual property protection that an e-commerce business would be concerned about are as follows:

- Copyrights for protection of the content, design of the websites, the software underlying the platform and the content transmitted over such platforms.
- Trademarks to protect the words, taglines or logos with which any person would identify with the e-commerce platform/ business. In addition to protecting their own trademarks, an e-commerce business that sells or markets other brands on its portal would have to ensure that such business’ trademarks are protected as well.
- Patents to protect (where allowed by law) the functionality of the software and the methods underlying such e-commerce. In India there is no patent protection for a computer programs per se and hence there is a need to look at alternate methods to protect software.

II. Common Issues with Respect to IP in E-Commerce

When any e-commerce platforms are created, the enterprise should use either proprietary technology or validly licensed technology.

A. Designing a Platform / Content Creation Through a Third Party

One of the most common scenarios where the question of ownership of IP arises is in the context of the website/ platform on which the business is carried out. Often e-commerce companies outsource the job of designing such websites/ platforms or creation of content to third party contractors. The issue here would be who would own the IP in the design and functionality (software underlying the website) of the website and in the content. Some of the important points for consideration in such circumstances would be as follows:

- A written agreement that clearly spells out the ownership of the IP including clauses on term, territory and the nature of right
- If third party IP is used by the contractors, it is important to understand the chain of title with respect to such third party IP and whether appropriate permissions have been acquired from such third parties
- A related issue here is the use of open source software. When open source software is used the company should be mindful of the terms and conditions under which such software has been licensed.

B. Use of Third Party Content on Website

It is essential to understand that that not all content available on the public domain can be used freely without obtaining the necessary permission or right from the owners of such content. Content could range from information to logos of third parties. In all of these instances the IP (such as copyright or trademarks) is owned by a third party and the e-commerce business necessarily has to obtain the

requisite approvals. Similarly providing links to other websites is a concern that needs to be addressed as well.

C. Hyperlinking, Framing and Meta Tagging

An important consideration for e-commerce companies is their ability to market their business and their ability to constantly adapt to and use technology to serve that purpose. In pursuit of achieving such marketing goals, e-commerce businesses sometimes have to deal with hyperlinking, deep linking,³⁷ framing³⁸ and meta tagging³⁹ issues and it is important to understand the legal implications of the same.

i. Illustration

if Company A's website provides an unauthorized link to Company B's website, or if Company A's website uses meta-tags that are similar to Company B's trademarks, Company A could be sued for violating Company B's IP. Apart from infringement of IP issues, issues relating to unfair competition may also arise.

Courts in many countries are grappling with issues concerning all of the above-mentioned activities. Courts in certain jurisdictions have held that hyperlinking; especially deep hyperlinking may constitute copyright infringement, whereas meta tagging may constitute trademark infringement.⁴⁰ Some examples of such cases are:

- The US courts have held in the cases of *Ticketmaster v. Tickets.com*⁴¹ and *Batesville Serv. Inc. v. Funeral Depot Inc.*⁴² that linking to another website could constitute copyright infringement.
- Further, it has been held in the cases of *Playboy*

*Enterprises Inc. v. Calvin Designer Lab*⁴³ and *Nat'l Envirotech Group L.L.C., Institution Technologies Inc. v. Nat'l Envirotech Group L.L.C.*⁴⁴ that using competitors' trade marks in the meta tags would be an infringement of such trademarks. The UK courts have also asserted the same view in the case of *Roadtech Computer Systems v Mandata Ltd*⁴⁵ and *Reed Executive plc and another v Reed Business Information and others.*⁴⁶

The Indian courts however have not dealt with these issues in detail.

D. Fair Dealing

In the context of an e-commerce business there is less likelihood of fair use defense available since commercial benefit is the underlying purpose of an e-commerce business.

E. Domain Names

A company that commences e-commerce activities would at first have to get its domain name registered. A domain name in simplistic terms is an address on the internet like www.ebay.in and www.google.com. In more technical terms a domain name is an easily recognizable and memorable name to the Internet Protocol resource (which is typically a set of numbers) of a website.⁴⁷

Domain names normally fall within the purview of trademark law. A domain name registry will not register two identical domain names but can register a similar domain name. This leads to a situation where deceptively similar domain names can be registered for example www.goooooogole.com by a third party. Any person visiting www.goooooogole.com might think that the content on this website belongs to or it has been sponsored by Google. In such cases trademark law comes to the rescue of Google. Further, while registering domain names, if

37. Hyperlink is a reference to a webpage or document on the Internet and deep hyperlink links to a specific interior page or paragraph inside a website surpassing the homepage.

38. Framing is the juxtaposition of two separate web pages within the same page.

39. Metatags are HTML codes that are intended to describe the contents of a web page but do not appear on the web page.

40. Cited from "Trademark Cases Arise from Meta-Tags, Frames: Disputes Involve Search-Engine Indexes, Web Sites within Web Sites, as well as Hyperlinking," Martin J. Elgison and James M. Jordan III and available at <http://cyber.law.harvard.edu/property00/metatags/mixed1.html> (last visited on January 22, 2015).

41. CV 97-3055 RAP (C.D. Cal., filed April 28, 1997).

42. No. 1:02-CV-01011-DFH-TA, 2004 WL 2750253 (S.D. Ind. Nov. 10, 2004).

43. 1997 U.S. Dist. Lexis 14345 (D. Cal. Sept. 8, 1997).

44. Civil Action 97-2064 (E.D. La.)

45. [2000] ETMR 970.

46. [2004] EWCA Civ 159

47. "Trade Marks & Emerging Concepts of Cyber Property Rights", V.K.Unni, 1st ed. 2002, Eastern Law House, p. 15-16.

the company chooses a domain name that is similar to some domain name or some existing trademark of a third party, the company could be held liable for cybersquatting.⁴⁸

Indian courts have been proactive in granting orders against the use of infringing domain names.⁴⁹ The take away from all these cases is that domain name serves the same function as a trade mark, and is not a mere address or like finding number on the internet, and therefore, it is entitled to equal protection as a trademark and that even an action for passing off can be filed for domain names. In fact in the case of *Satyam Infoway Ltd. v. Sifynet Solutions Pvt. Ltd.*,⁵⁰ the Supreme Court had also held that “a domain name may pertain to the provision of services within the meaning of section 2(z) of the Trade Marks Act, 1999.”

III. Enforcing IP - Liability for Infringement of IP

In order to evaluate the need for protecting one's IP and/ or not infringing on a third party's IP, it is vital to have grasp of the extent of liability for infringement of an IP.

The issue of liability for infringement of IP gets even more complicated with the vastness of the internet world which makes the duplication, or dissemination of IP protected works easy and instantaneous and its anonymous environment makes it a challenge to detect the infringer. Moreover, infringing material may be available at a particular location for only a very short period of time.⁵¹ In determining the possible liability (be it under a statute of common law) that could arise for infringement of an IP, the fact IP protection is territorial in nature needs to be emphasized. This aspect has been discussed in greater detail in the section '*Jurisdiction*'.

What amounts to an infringement varies for each form of IP? There are a host of factors that a court would consider in deciding whether or not there is an infringement of copyright or trademark or as the case may be. We have discussed these factors in greater detail in our research paper "**Intellectual Property in India**" available at our website: <http://www.nishithdesai.com/Research/Paper/Intellectual%20Property.pdf>

Some of the most common forms of liability for infringement in India would be:

- Injunction (temporary or permanent) against the infringer stipulating that the infringing activity shall not be continued.
- Damages to the extent of lost profit or damages to remedy unjust enrichment of the infringing party.
- Order for accounts of profits
- Order for seizure and destruction of infringing articles.

In addition to the civil remedies, some of the IP laws contain stringent criminal provisions relating to offenses and penalties such as imprisonment of up to three years for applying for a false trademark⁵², knowingly infringing a copyright⁵³ and for applying for a false geographical indication.⁵⁴

48. _____

49. Some of the cases in which injunctions against the use of conflicting domain names have been granted are: *Yahoo Inc. V. Aakash Arora & Anr AIR 2000 Bom 27*; *Rediff Communication v. Cyberbooth & Anr 1999 PTC (19) 201* and *Satyam Infoway Ltd. v. Sifynet Solutions Pvt. Ltd. AIR 2004 SC 3540*.

50. AIR 2004 SC 3540.

51. "Hosts" and web page creators can delete files within a matter of hours or days after their posting.

52. Section 103 of the Trademark Act, 1999.

53. Section 63 of the Copyright Act, 1957.

54. Section 39 of the Geographical Indication of Goods Act, 1999.

9. Content Regulation

For the e-commerce ventures that distribute content or acts as a platform for distribution or exchange of third party information/ content, compliance with content regulations assumes paramount importance. There is no single legislation in India that would deal with regulation of content in India; rather a plethora of legislations would come into play coupled with judicial interpretations. It would be essential for any e-commerce business to be mindful of such laws primarily because an e-commerce website acts as a platform for several third party information/ content and it is important to examine if such content would be objectionable under any of the laws. In this chapter we discuss some of the important statutes which deal with content regulation.

I. Obscenity Issues

In India there are a number of statutes that provide for regulations relating to obscenity.

A. IPC

Any material which is lascivious or appeals to the prurient interest or which may deprave and corrupt persons would be considered obscene and publicly exhibiting such obscene material (which may include posting on a website) would attract liability under Section 292 of the IPC. Liability could be in the form of imprisonment and fine.⁵⁵ Further, increased liability is attracted when such obscene material is made available to young persons.⁵⁶ In fact, the wide accessibility to internet by all persons of all age groups may make it difficult to prove that any material considered obscene was not made available to young persons.

i. Determination of Obscenity

In determining whether or not the content depicted on an e-commerce website is lascivious or appeals to the prurient interest, the court would take into consideration factors such as - (a) whether the work taken as a whole appeals to the prurient interest; (b) whether the work is patently offensive; (c) whether the work taken as a whole, lacks serious literary, artistic, political or scientific value.⁵⁷ The court would also take into account other factors depending on the facts and circumstances of the case.

B. Indecent Representation of Women (Prohibition) Act, 1986 (“IRWPA”)

An indecent representation of a woman which includes depiction of the figure of a woman, her form or body or any part which has the effect of being indecent, or derogatory to, or denigrating, women, or is likely to deprave, corrupt or injure the public morality or morals is punishable under the IRWPA.⁵⁸ Since the definition is broad enough to bring within its ambit

C. IT Act

Under the IT Act, anyone who publishes or transmits or causes to be published or transmitted in an electronic form (a) any material which is lascivious or appeal to the prurient interest or which may deprave and corrupt persons; or (b) any material which contains sexually explicit act or conduct would be liable under this Act. Whether or not the material is lascivious or contains sexually explicit acts would be determined by the court based on the factors already stated above.⁵⁹

55. For violation of this section of the IPC, the Company would be liable for imprisonment for a term up to 2 years and a fine up to INR 2,000 for the first time offenders. In case of second or subsequent conviction, then it is punishable with imprisonment of up to five years, and a fine up to INR 5,000.

56. The Company would be liable with imprisonment of up to 3 years, and with fine up to INR 2,000 on first conviction, and, in the event of a second / subsequent conviction, with imprisonment up to 7 years, and also with fine up to INR 5,000.

57. *Director General, Directorate General of Doordarshan & Ors vs Anand Patwardhan & Anr* (Appeal (civil) 613 of 2005 of Supreme Court).

58. If held guilty under IRWPA, it would attract a penalty of imprisonment for up to two years, and with fine up to INR 2000 on first conviction and in the event of a second / subsequent conviction with imprisonment of up to 6 months but which may extend to 5 years and also with a fine not less than INR 10,000 which may extend to INR 1,00,000.

59. If the Company is held to be guilty under the first offense mentioned above, a penalty of up to three years imprisonment and fine of up to five lakh rupees would get attracted for first conviction and in the event of a second or subsequent conviction a penalty of up to five years imprisonment and fine of up to ten lakh rupees would get attracted. In case of the second offense, a penalty of up to five years imprisonment and fine of up to ten lakh rupees would get attracted for first conviction and in the event of a second or subsequent conviction a penalty of up to seven years imprisonment and fine of up to ten lakh rupees would get attracted.

The definition of obscenity under Indian laws is wide and essentially depends on the capacity of the alleged obscene object to “deprave and corrupt”.

II. Defamation

A. What is Defamation?

Section 499 of the IPC defines defamation as any act of making or publishing any imputation concerning a person with

- The knowledge, or
- The intention; or
- The reason to believe

that such imputation will harm the reputation of such person. There are certain exceptions set out in this section such as

- i. It is not defamation to impute anything which is true concerning any person, if it be for the public good
- ii. It is not defamation to express in good faith any opinion respecting the merits of any public performance

The punishment of defamation is simple imprisonment for up to two years and/or with fine.

B. Sale of Defamatory Matter

Section 500 of the IPC also makes it an offence to sell or offer for sale any printed or engraved substance knowing that such substance contains defamatory matter. The punishment for this offence is simple imprisonment for up to two years and/or with fine. Hence, an e-commerce portal may also be liable where

- i. It advertises products containing defamatory matter irrespective;
- ii. It itself sells any defamatory matter.

Very often e-commerce portals have inter-active / open platforms where users can post views and comments and interact with each other. Adequate steps should be taken to ensure that no defamatory comments are posted on such spaces.

10. Intermediary Liability

I. Who is an Intermediary?

Intermediary is defined under the IT Act as any person who on behalf of another person receives, stores or transmits that record or provides any service with respect to that record and includes telecom service providers, network service providers, internet service providers, web hosting service providers, search engines, online payment sites, online-auction sites, online market places and cyber cafes.⁶⁰

II. Is an Intermediary Liable for Third Party Actions?

When an e-commerce website merely provides a platform and acts as an intermediary between different parties, the question that then arises is - what is the extent of liability of such e-commerce companies for acts of third parties? Is the intermediary to be held liable for the actions of third parties who may make use of the platform provided by the intermediary for their illegal activities?

Section 79 of the IT Act provides for exemptions to the liability of intermediaries if certain requirements have been fulfilled such as:

- i. the intermediary merely provides access to a communication system over which information made available by third parties is transmitted or temporarily stored or hosted; or
- ii. the intermediary does not at its instance
 - initiate the transmission;
 - determine the receiver of the transmission,
 - choose or alter the information contained in the transmission; and
- iii. the intermediary observes due diligence or any guidelines issued by the Central Government in this regard.⁶¹

The IT Act also provides that exemption from liability shall not apply if “*upon receiving actual knowledge, or on being notified by the appropriate Government or its agency that any information, data*

or communication link residing in or connected to a computer resource controlled by the intermediary is being used to commit the unlawful act, the intermediary fails to expeditiously remove or disable access to that material on that resource without vitiating the evidence in any manner”.⁶²

In furtherance of last requirement to be fulfilled by intermediaries to qualify for the exemption, the Central Government in April 2011 also issued the Information Technology (Intermediaries Guidelines) Rules, 2011 (“**Intermediaries Rules**”). The Intermediaries Rules stipulate in detail the due diligence procedures which need to be observed by an intermediary and some of the important aspects are as follows:

- The intermediary must publish the rules and regulations, privacy policy and user agreement for access or usage of the intermediary's computer resource by any person. Such rules and regulations must inform the users of computer resource not to host, display, upload, modify, publish, transmit, update or share certain prescribed categories of prohibited information.
- The intermediary must not knowingly host or publish, any prohibited information and must disable the same within 36 hours of knowledge about the same, and where applicable work with the user or owner of the information to disable such information.⁶³

Therefore an e-commerce company can ensure that any liability arising by virtue of providing a platform for third parties can be pre-empted by adhering to these guidelines. This is increasingly important with vigilance over a large volume of users of such e-commerce websites becoming nearly impossible.

On the other hand, one of the common concerns regarding the abovementioned provision, lay in the requirement for the intermediary to remove / block access to illegal content upon receiving knowledge of such illegality – this knowledge could be obtained by an intermediary on its own (perhaps through monitoring of the content), or communicated to the intermediary by any affected person, or via notification by the government. This provision led to speculation in the industry on two fronts:

60. Section 1(w) of the IT Act

61. Section 79 (2) of the IT Act.

62. Section 79(3)(b) of the IT Act

63. Rule 3 of the Intermediary Rules.

- By requiring the intermediary to use its own judgment to deem content to be illegal i.e. where the intermediary received knowledge of illegal content on its own or even by any affected person, as opposed to by way of a government / court order, the IT Act and the Intermediary Rules effectively made an intermediary a gatekeeper to the internet, giving an intermediary the discretion to decide upon whether or not certain content should be blocked.
- The language used in the Intermediary Rules (i.e. the requirement of the intermediary to “act within 36 hours” of receiving knowledge) caused much speculation in the industry as it was not clear what constituted appropriate action and whether the intermediary was supposed to act on any and all take down notifications (from the government as well as private parties).

In the Supreme Court’s landmark judgment⁶⁴ in the case of *Shreya Singhal v Union of India*⁶⁵, the petitioners *inter alia* challenged the constitutionality of Section 79 of the IT Act, and the Intermediary Rules, stating that these provisions were vague, and broad and in violation of Article 19 of the Constitution of India which provides for the fundamental right to the freedom of speech and expression, and certain reasonable restrictions to this fundamental right.⁶⁶

The petitioners have argued that Section 79, and the Intermediary Rules violate the Constitution in that they (a) allow the intermediary (as opposed to a court / statute) the discretion to decide upon whether an ‘unlawful act’ is being committed, or restricted content is being published; and (b) the restrictions under the Intermediary Rules go beyond the permitted restrictions under Article 19(2).

The Supreme Court in its judgment, held that the provisions regarding the issue of ‘knowledge’ of the intermediary, and the consequent actions to be taken by the intermediary, i.e. Section 79(3)(b) of the IT Act, and Rule 3(4) of the Intermediary Rules are to be read down to mean that the **intermediary must receive a court order / notification from a government**

agency requiring the intermediary to remove specific information.

Further, the Supreme Court has also stated that any such court order or notification must necessarily fall within the ambit of the restrictions under Article 19(2) – therefore providing that any order for removal of content that is considered ‘illegal’ must fall within the reasonable restrictions provided for under Article 19(2) of the Constitution of India i.e. such removal must be in the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence.

The judgment of the Supreme Court has provided some clarity by reading down the provisions of Section 79 and the Intermediary Rules and stating that the intermediary must receive a court order / notification from a government agency for removing specific information / content. However, there is still no clarity on which specific administrative agencies would have the authority to issue such an order.

Another question that flows from the Supreme Court’s judgment is whether such a reading down hampers protection of individuals, since intermediaries would not be obligated to undertake any take down / removal action upon receipt of third parties complaints (however grave and severe) even if the complaint on its face merits take down. As a result, illegal content (that could potentially cause loss or injury) would continue to be viewed in public domain until a court order or administrative order is received – a process which may take substantial time.

III. Exemption from liability vis-à-vis copyright and patent laws

Section 81 of the IT Act provides that nothing contained in the IT Act will restrict any person from exercising the rights granted to them under the Copyright Act, and the Patents Act, 1970 (“**Patents**

64. Our firm’s detailed analysis of this judgment is available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/freedom-of-speech-online.html?no_cache=1&cHash=535fc9875596c33b8be7ab7e3c8df661

65. Writ Petition (Criminal) No. 167 of 2012

66. **Article 19: Protection of certain rights regarding freedom of speech etc.**

(1) All citizens shall have the right

(a) to freedom of speech and expression;

.....

(2) Nothing in sub clause (a) of clause (1) shall affect the operation of any existing law, or prevent the State from making any law, in so far as such law imposes reasonable restrictions on the exercise of the right conferred by the said sub clause in the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence [Emphasis supplied]

Act”). This provision is overarching, and applies to all provisions of the IT Act, including those relating to intermediaries.

In the case of *Super Cassettes Industries Ltd. Vs. Myspace Inc. and Anr.* (2011(48)PTC49(Del)) the court found MySpace guilty of primary copyright infringement under S.51(a)(ii) of the Copyright Act and passed an injunctive order restraining the defendants from dealing with the plaintiff’s works, including modifying them, adding advertisements, or making profits from the same, without enquiring about the ownership of the works.

- The plaintiff, a well know music house in India who claimed to be the owner of copyrights in the repertoire of songs, cinematograph films, sound recordings sued the defendant who are the owners a social networking and entertainment website ‘MySpace.com’ (which offered a variety of entertainment applications including sharing, viewing of music, images) on grounds of copyright infringement of the plaintiff’s repertoire.
- The defendants, *inter alia* argued that they are an intermediary within the meaning of the IT Act and are thus not liable for the third party activities on the website by reason of the safe harbours granted under the provisions of Section 79 of IT Act.
- The court did not accept this argument on various grounds including that Section 79 has to be read in conjunction with Section 81 of the IT Act⁶⁷, which makes it clear that thought the provisions of IT Act may override other laws for the time being in force, they cannot restrict the rights of the owner under the Copyright Act and the Patents Act. Thus, it may be inferred that Section 79 of the IT may provide safe harbor against internet related wrongs such as uploading of pornographic content but not to copyright infringement or patent infringement claims which have been specifically excluded by way of proviso to Section 81 provided that the intermediary has complied with the requirements of Section 79.

This case is pending final determination.

However, with the amendments to the Copyright Act in 2012, and the notification of the Copyright Rules, in 2013, a notice and take down procedure which grants some protection to intermediaries has been established under the copyright regime in India. The Copyright Act (as amended) provides that any “*transient or incidental storage of a work or performance for the purpose of providing electronic links, access or integration, were such links, access or integration has not been expressly prohibited by the right holder*”⁶⁸ is not an act of infringement of copyright unless the person responsible for such storage (i.e. an intermediary) is aware or has reasonable grounds for believing that the work/ performance stored is an infringing copy.

The Copyright Act also provides that if the intermediary responsible for such storage has received a written complaint from the owner of copyright in the work alleging that such storage is an infringement of the work, the intermediary should stop facilitating access to the work for a period of 21 days or until he receives an order from a competent court regarding the matter.

These provisions should provide intermediaries some reprieve in cases of alleged copyright infringement, under the Copyright Act, even if they are unable to obtain protection / exemption from liability under the IT Act and the Intermediary Rules.

67. Section 81 of IT Act: *‘The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.*

Provided that nothing in this Act shall restrict any person from exercising any right conferred under the Copyright Act 1957 or the Patents Act 1970.’

68. Section 52(c), Copyright Act, 1957

11. Jurisdiction Issues

In any dispute, one of the primary issues that a court determines is whether or not the said court has jurisdiction to try the dispute; a court must have both subject-matter jurisdiction (i.e. jurisdiction over the parties involved in the dispute) and territorial jurisdiction. The increased use of the internet has led to a virtual world which is not possible to be restricted in terms of traditional concepts of territory; this has led to complications in determining jurisdiction. According to the traditional rules of jurisdiction determination, the courts in a country have jurisdiction over individuals who are within the country and/or to the transactions and events that occur within the natural borders of the nation.⁶⁹

Therefore in e-commerce transactions, if a business derives customers from a particular country as a result of their website, it may be required to defend any litigation that may result in that country. As a result, any content placed on an e-commerce platform should be reviewed for compliance with the laws of any jurisdiction where an organization wishes to market, promote or sell its products or services as it may run the risk of being sued in any jurisdiction where the goods are bought or where the services are availed of.

Jurisprudence in India with respect to issues relating to jurisdiction and enforcement issues in e-commerce is still nascent.

In general a lot of local statutes provide for a '**long arm jurisdiction**' whereby the operation of such local laws have extra-territorial application if an act or omission has resulted in some illegal or prejudicial effect within the territory of the country. Below we set out certain provisions of Indian laws which provide for such long arm jurisdiction:

I. IT Act

Section 1(2) of the IT Act read along with Section 75 of the IT Act provides that

- the Act shall extend to the whole of India and, save as otherwise provided under the Act, it shall apply also to any or contravention thereunder

committed outside India by any person and

- the Act shall apply to any offence or contravention committed outside India by any person if the act or conduct constituting the offence or contravention involves a computer, computer system or computer network located in India.

II. Indian Penal Code, 1869 ("IPC")

Section 3 of the IPC provides that any person who is liable, by any Indian law, to be tried for an offence committed beyond India shall be dealt with according to the provisions of the IPC for any act committed beyond India in the same manner as if such act had been committed within India.

There does not seem too much jurisprudence in India on the issue of jurisdiction in cases of e-commerce. However there are some instances wherein the courts had in the preliminary stages assumed jurisdiction over a matter. In the case of *SMC. Pneumatics (India) Pvt. Ltd. v. Jogesh Kwatra*,⁷⁰ the Delhi High Court assumed jurisdiction where a corporate's reputation was being defamed through e-mails.

III. International Jurisprudence

The US courts have developed the "minimum contacts" theory whereby the courts may exercise personal jurisdiction over persons who have sufficient minimum contacts with the forum state. These "minimum contacts" may consist of physical presence, financial gain, stream of commerce, and election of the appropriate court via contract.⁷¹

In the case of *Cybersell Inc v CyberSell Inc*⁷², the plaintiff, Cybersell AZ, was an Arizona corporation that provided Internet advertising and marketing services. The defendant, Cybersell FL, was a corporation run from Florida by a father and son team that offered web marketing and advertising

69. Paras Diwan and Piyush Diwan, "Private International Law", 4th rev., Deep & Deep Publications, New Delhi.

70. Suit No. 1279/2001. This case is still pending. Orders available on Delhi High Court website http://delhihighcourt.nic.in/dhc_case_status_list_new.asp (last visited on January 22, 2015)

71. *International Shoe Co v Washington (1945)* cited from "A Separate Jurisdiction for Cyberspace?" by Juliet M. Oberding and Terje Norderhaug available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1083-6101.1996.tb00186.x/abstract> (last visited on January 22, 2015).

72. 130 F.3d 414 (9th Cir. 1997)

consulting services. Cybersell FL did no advertising in Arizona, and had no offices, employees, or clients in the state. Cybersell AZ discovered the existence of the Cybersell FL, and informed them of the existence of their registered service mark. Cybersell AZ initially filed suit in the District Court of Arizona. Cybersell FL moved to dismiss for lack of personal jurisdiction, and the courts granted their motion holding that the defendant's web site was "essentially passive" and that it did not "deliberately" direct its efforts towards Arizona residents.

It should be noted that the case cited in this section relates an instance where both plaintiffs and defendants are from the US and may not hold good in the case of international / cross border situations.

12. Taxation of E-Commerce Transactions

In absence of national boundaries and physical nature of transacting in goods/ services (as is the case with traditional commerce), taxation of e-commerce activities raises several issues. As discussed in Chapter IV, with the accessibility to internet across borders, e-commerce transactions can involve people who are resident of more than one country. Therefore, income arising out of such transactions may be taxed in more than one country.

The policies framed by the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (“OECD”) highlighted *neutrality; efficiency; certainty and simplicity; effectiveness and fairness; and flexibility* as guiding principles for the taxation of e-commerce transactions.⁷³

In India, the High Powered Committee (“HPC”) constituted by the Central Board of Direct Taxes, submitted its report in September 2001. The report considered and contemplated upon the need for introducing a separate tax regime for e-commerce transactions. The report prepared by the HPC took into account the principles laid down by the OECD albeit with some exemptions.⁷⁴ However, based on the principle of ‘neutrality’⁷⁵, the HPC maintained that the existing laws are sufficient to tax e-commerce transactions⁷⁶ and no separate regime for the taxation of e-commerce transactions is required.

Indian tax authorities have been seeking to tax e-commerce and internet-based business models in a manner that conflict with international approaches. Global enterprises catering to Indian customers have faced difficulties as a consequence and there has been significant litigation in this respect, especially in relation to characterization of income and withholding taxes. Therefore, it becomes important to carefully structure e-commerce business models so as to mitigate tax risks, especially risk of taxation in more than one country (without availability of credit

for payment of taxes in countries other than the country of tax residence).

I. Direct Taxes

Taxation of income in India is governed by the provisions of the Income Tax Act, 1961 (“ITA”). Under the ITA, residents are subject to tax in India on their worldwide income, whereas non-residents are taxed only on income sourced in India. As per Section 9 of the ITA, certain types of income (such as interest, royalty, income from any capital asset situated in India, etc), are deemed to accrue or arise in India under prescribed circumstances. However, if a non-resident taxpayer is a tax resident of a country with which India has signed a tax treaty, he is entitled to relief under the tax treaty.

Business profits (net of permissible deductions) are taxed at 30 percent⁷⁷ in case of resident companies and 40 percent in case of non-resident companies (to the extent of income sourced in India). Withholding tax of 25% is applicable on a gross basis in case of royalties and fees for technical services (“FTS”) paid to non-residents (which could be reduced under an applicable tax treaty). In case of failure to withhold, the payer could be liable for the principal tax amount, interest (at 12% per annum) and penalty (up to 100% of the principal tax amount). Further, the payer could face the risk of not being allowed to claim expense deduction (for the royalty / FTS payment) while computing its taxable profits.

The 2015 Budget has proposed to reduce the corporate tax rate from 30% to 25% (excluding surcharge and cess) over the next four years, coupled with rationalization and removal of various exemptions and rebates. Surcharge on the other hand, has been increased by 2% for domestic companies, thereby increasing maximum effective rates to 34.61%. Withholding rates applicable in case

73. “Electronic Commerce: Taxation Framework Conditions” a Report by the Committee on Fiscal Affairs, OECD, retrieved from :<http://www.oecd.org/ctp/consumptiontax/1923256.pdf>

74. Ibid

75. Principle of Neutrality: Tax policy must not penalize businesses and consumers who choose to conduct transactions electronically rather than through traditional channels of commerce. Goods or services should receive the same tax treatment regardless of delivery method, and compliance burdens and costs should not be heavier for businesses and consumers who conduct business electronically than for those who engage in traditional commerce.

76. The eCom Taxpert Group, “Taxation of Electronic Commerce in India”, [2002] *Asia-Pacific Tax Bulletin* July/August 241

77. All tax rates mentioned in this paper are exclusive of surcharge and cess. The tax rates mentioned in this response are exclusive of surcharge and cess; in case of residents, surcharge of 10% / 5% is applicable on the income-tax if their total taxable income is in excess of INR 10 crores / in excess of INR 1 crore but less than INR 10 crores respectively; in case of non-residents, the surcharge is 5% / 2% respectively for such taxable income; for both resident and non-residents, education and higher education cess of 3% (cumulative) is applicable on the total of the income-tax and surcharge.

of royalty and fees for technical services to offshore entities are proposed to be reduced from 25% to 10% (on a gross basis).

With respect to taxation of income generated by non-residents from e-commerce transactions, primarily, there are two main issues: *a*) Characterization of income i.e. whether income earned with respect to the use or sale of goods (particularly items such as software and electronic databases), sale of advertising space etc is royalty or business income or capital gains, and *b*) permanent establishment (PE) issues that may arise due to the presence of a server / other electronic terminal in India, hosting of websites or other technical equipment, etc.

A. Characterization of Income

The tax treatment of income earned by a non-resident would depend on the characterization of such income, and may be examined under the heads *viz.* business income, royalties or fee for professional services.

Ordinarily, business profits earned by a non-resident

are taxable as follows:

Therefore, characterization of income impacts the tax cost of doing business in India. Particularly, where characterization by Indian tax authorities is not in consonance with international principles, non-residents could potentially face the risk of double taxation (arising from non-availability of credit for taxes paid in India).

In determining whether a payment amounts to royalty, several issues arise in the Indian context as the definition of royalty under the ITA (particularly, after the clarificatory amendment introduced in 2012) is wider than the definition accepted internationally. The definition covers consideration received for license of computer software that does not involve the transfer of any underlying intellectual property. This deviates from internationally accepted principles which treat such license like a simpliciter sale of copyrighted books. The domestic law definition of 'royalty' also includes payments for access to or use of scientific / technical equipment even if no control / possession is granted over the equipment (for example, hosting website on third party servers without renting the

| | When the non-resident does not have a PE / business connection⁷⁸ in India | When the non-resident has a PE / business connection in India |
|--|---|--|
| Business profits qualifying as royalties | Taxable on a gross basis at 25% (or at lesser rates prescribed under a tax treaty) | Taxable at 40% to the extent of profits attributable to the PE (net of permissible deductions) |
| Business profits qualifying as FTS | | |
| Business profits not qualifying as royalties and FTS | Not taxable | |

server / obtaining any administrator rights over the server). This again is a deviation from internationally accepted principles which do not treat such payments as royalty unless the payer is also given control / possession over the equipment.

Further, under domestic law, payment of royalty between two non-residents is also considered to be sourced in India, if the payer utilizes the information, property or rights for a business or profession carried out in India. For example, if a non-resident licenses any IP from another non-resident for onward licensing (either independently or in combination with other IP) to a resident in India, the payment made for the former license could be taxable in India, subject to relief under an applicable tax treaty.

But, as outlined above, a non-resident is entitled to the benefit of the more restricted definition of 'royalty' prescribed under tax treaties. However, India has expressed several reservations to the OECD commentary on the definition of 'royalty' and Indian tax authorities have many a times contended that tax treaty provisions should be interpreted as per domestic law definitions. We discuss below some key issues in this regard that could be faced in case of e-commerce transactions.

From the perspective of an e-commerce transaction, the issue of characterization of income becomes relevant in various circumstances, For example, payments received from residents making online purchase of digital products such as podcasts, online subscriptions, shrink-wrap software, etc., could fall

⁷⁸ Business connection is the corresponding domestic law concept, which would be applicable in the absence of a tax treaty. Its ambit is generally wider than the ambit of PE as defined under tax treaties.

within the ambit of royalty, notwithstanding that they are merely a sale of a good in electronic form. Similarly, income derived from granting rights to use a copyrighted article, for example, by way of an online copy of a book, could also be characterized as royalty income in the hands of the recipient of income under the current domestic provisions. However, with respect to the characterization of income earned in connection with a copyrighted article versus a copyright, the position is yet not settled in a treaty situation. Additionally, add-ons and updates to existing digital products or software could also fall under the purview of 'royalty'.

As regards embedded software, the 2012 clarificatory amendment makes it clear that income generated by way of sale of embedded software would also be characterized as royalty income under the ITA; but, a different position may be taken in the context of tax treaties. As per internationally accepted principles, the license of software is considered to be incidental to the sale of the product / hardware / device in which the software is embedded and therefore, any consideration received for such license of software is clubbed with the consideration for sale of the product / hardware / device and is therefore not characterized separately. An example of embedded software could be the setting up of an integrated GSM system for mobile phones that uses both hardware and software. On this point, the Delhi High Court⁷⁹ on two instances has taken the view that the software that was loaded on the hardware did not have any independent existence and formed an integral part of the GSM mobile telephone system and it cannot be said that such software is used by the cellular operator for providing the cellular services to its customers.⁸⁰

However, in a recent case involving sale of software and hardware as an integrated product, the Mumbai Tribunal⁸¹ held that consideration payable for the software is taxable as royalty. The tribunal came to such conclusion for the following reasons: (i) the hardware and software were sold under separate agreements; and (ii) license of software (even if made without license of underlying IP) amounts to transfer

of a right in respect of a copyright contained in a copyrighted article.

Another popular cross border e-transaction is data warehousing, which involves the storage of computer data by the customers on servers owned and operated by the providers. In this context, the *Delhi Tribunal*⁸² has held that where the taxpayer availed of data processing services performed by a company based out of India, for its Indian operations, then in the absence of any right to secret process that was made available by the foreign company to the taxpayer coupled with the fact that the foreign company performed support functions using its own intellect, there can be no income in the nature of royalty.

Further, even in case of e-commerce business models involving the use of or access to different kinds of scientific / industrial equipment (for example, in case of bandwidth services, medical diagnosis, etc.), where no control / possession is granted to the service recipient, the domestic law definition of 'royalty' (as retroactively amended in 2012) is wide enough to cover payments thereof. Internationally, such payments are not construed as 'royalty' unless some element of control / possession is also granted over the equipment. Therefore, while interpreting tax treaties (which override domestic law), courts have held in cases like *Dell*⁸³ that such payments do not constitute 'royalty'. Further, in the context of online banner hosting / advertisements, in cases like *Yahoo*,⁸⁴ it has been held that the payer should be able to operate the scientific / industrial equipment on its own. As the payer was not able to operate the website on its own, but was only benefitting from the advertisement being hosted by the payee on its website, it was held that the payment did not constitute royalty.

However, the Indian tax authorities have been contending that, even as per India's tax treaties, no element of control / possession is required to characterize payment for use of equipment as 'royalty'. In some case like *IMT Labs*⁸⁵ and *Cargo Community Network*,⁸⁶ it has been held that

79. *Director Income Tax v. Ericsson AB*, [2012] 343 ITR 470 (Delhi); *Director Income Tax v. Nokia Networks OY* (2012) 253 CTR (Del) 417.

80. A similar position was taken by the Delhi High Court in the case of *Director Income Tax v. Nokia Networks OY* (2012) 253 CTR (Del) 417

81. *DDIT vs. Reliance Infocomm Ltd/Lucent Technologies*, 2013 (9) TMI 374

82. *Standard Chartered Bank v. DDIT*, [2011] 11 taxmann.com 105 (MUM)

83. *Dell International Services (India) Pvt. Ltd., In re*, 305 ITR 37 (AAR); Similar position was also taken in the case of *Cable and Wireless Networks India (P) Ltd., In re*, 315 ITR 72 (AAR).

84. *Yahoo India Pvt. Ltd. v. DCIT*, ITA No.506/Mum/2008; Similar position was also taken in the cases of *Pinstorm Technologies Pvt Ltd v. ITO*, TS 536 ITAT (2012) Mum and *ITO v. Right Florists Ltd*, I.T.A. No.: 1336/ Kol/ 2011

85. *In re: IMT Labs (India) P. Ltd.*, [2006] 287 ITR 450 (AAR).

86. *In re: Cargo Community Network Pte Ltd*, [2007] 289 ITR 355 (AAR).

payment received by a non-resident from Indian customers for providing access to software/portal hosted on its server outside India is royalty, even though the non-resident did not grant any control / possession over its server to the Indian customers. This approach appears to be particularly gaining momentum in light of the 2012 retrospective amendment of the domestic law definition. Recently, in the case of *Cognizant*⁸⁷, it was held that payment for bandwidth services and router management services is 'royalty'. In interpreting the definition of 'royalties' under the applicable (India-US) tax treaty, the judgment did not follow internationally accepted approaches and instead relied upon the ITA provisions. This is in contrast with other decisions⁸⁸ which have held that amendments made under domestic law cannot be relied upon for the interpretation of provisions in tax treaties.

In the context of characterization as FTS, in case of online auctioning websites, the Mumbai Tribunal in the case of *Ebay*⁸⁹ has held that marketing support services rendered by the Indian group companies to the foreign company could not be considered as FTS.⁹⁰ Further, in respect of web hosting, the Mumbai Tribunal in the case of *ITO v. People Interactive (P) Ltd.*, held that payments made by a resident to a non-resident for providing web hosting services whereby the resident does not have any access to the equipment and machines, could only be regarded as payments made for availing services. However, this view is a departure from the earlier view of courts⁹¹ with respect to the issue of web hosting.

Apart from the ones mentioned above, there are various other e-commerce transactions which have not yet been tested in the court of law yet, and the characterization of such transactions still remains uncertain. Examples being payments made for the maintenance of software, website hosting, data warehousing, data retrieval, delivery of high value data.

In addition to software payments, e-commerce income arises from online shopping portals offering digital and tangible products, website like snapdeal.com offering and deals online and charging a commission for them, CRS websites, e-banking. In

case of online platforms of tangible products, it is relatively simpler to characterize the income thereof as income from business profits. However in case of composite services like e-banking, access to paid databases, sale of digitized book issues, webhosting, etc., issues arise with respect to characterization.

B. Permanent Establishment in E-Commerce

Generally, a creation of PE requires the enterprise to carry out an income generating business in the other contracting state. In the context of e-commerce, due to the intangible nature of transactions, it is difficult to determine the existence of a PE based on the existing tests laid down for determination of a PE.⁹²

Internationally, merely advertising on a website about the products and services by itself would not constitute a PE. However, if the business is being carried out through a website and the website owner owns / has rented the server on which the website is hosted or otherwise has the server at its disposal, the server in such an instance may constitute a PE (as the server constitutes a "fixed place of business" of the enterprise⁹³). But, a third party website hosted on a computer server of an internet service provider should not result in the server being at the disposal of the enterprise owing the website and therefore, such hosting should not create a server PE. This principle has been upheld by Indian courts in relation to advertisement revenue earned by Google and Yahoo from India.⁹⁴

However, Indian tax authorities have been contending a website could constitute a PE in certain circumstances and have expressed reservations to the OECD commentary in this regard. Some other important reservations pertain to PE exposure from (i) websites hosted on a third-party server which is not leased or otherwise available at an enterprise's disposal; and (ii) leased automated equipment which is not operated and maintained by the lessor enterprise post set-up. On-line reservations and bookings for airlines, trains and other travel agencies is often routed through CRS which allow real-time access airline fares, seating availability, schedules and

87. *DCIT v. Cognizant Technology Solutions India Private Limited*, ITA Nos. 1535, 1536/09, ITA 460 & CO.27/2010, ITA Nos. 751, 864 & 1922/Mds/2010.

88. *DIT v. Siemens Aktiengesellschaft*, ITA No. 124 of 2010 (Bom); *DIT v. Nokia Networks OY*, 253 CTR 417 (Delhi).

89. *Ebay International AG v. DDIT*, [2012] 25 taxmann.com 500 (Mum.)

90. *Ebay International AG v. DDIT*, [2012] 25 taxmann.com 500 (Mum.)

91. Re: IMT Labs (India) (P) Ltd. (2005), 157 Taxman 213, 287 ITR 450; In re. Cargo Community Network Pte Ltd 289 ITR 355(AAR)

92. The existing tests for determination of PE are – Service PE, Fixed place of business PE, Agency PE, Warehouse PE, Construction, Installation and Supervisory PE.

93. OECD Model Tax Convention (2005), Condensed version, Page 110

94. *ITO v. Right Florists Limited*, I.T.A. No.: 1336/ Kol/ 2011

enabling the bookings, reservations and generation of tickets. The issue of taxation of income based on the location of the CRS has been dealt with in a few judgments. The Delhi Tribunal in the cases of *Galileo International*⁹⁵ and *Amadeus Global Travel v. Deputy Commissioner Income Tax*⁹⁶, concluded that non-resident companies providing computerized reservation system are liable to be taxed in India to the extent of booking fees received from Indian residents. The Tribunal came to such conclusion on the ground that these companies have a “virtual” presence in India which constitutes a “virtual” PE.

C. Transfer Pricing Framework

i. International Transfer Pricing

Commercial transactions between related entities of multinational corporations increasingly dominate the sphere of world trade. In India, the transfer pricing regulations (“**Regulations**”) provide for a mechanism for computation of the arm’s length price (“**ALP**”) of income arising out of ‘international transactions’ between associated enterprises. Recently, the term ‘international transaction’ has been defined in an inclusive manner with retrospective effect. Important among the transactions included are the following, which were previously considered to be outside the scope of transfer pricing on account of the absence of an element of income or gain in such transaction:

- i. capital financing; or
- ii. transaction of business restructuring or reorganisation, irrespective of the fact that it has bearing on the profit, income, losses or assets of associated enterprises at the time of the transaction or at any future date.

However, recently, in the second landmark *Vodafone ruling*,⁹⁷ the Bombay High Court held that transfer pricing would be triggered only when an element of real ‘income’ is involved and that notional income or hypothetical income is not subject to transfer pricing regulations.

To reduce transfer pricing disputes arising with respect to determination of ALP, recently, safe harbor rules and Advanced Pricing Agreements (“**APA**”) have been introduced.

Safe-harbour rules prescribe thresholds, satisfaction of which binds the tax authorities to accept the transfer price declared by the taxpayer. The safe-harbour thresholds notified by the government are applicable for five financial years beginning from 2012-13. Under the APA framework, taxpayers can negotiate an APA with the tax authorities for determining the ALP or specifying the manner in which it must be calculated, in relation to international transactions to be entered into by the taxpayer for a period of up to five years. Recently, APAs have been permitted to be rolled back for a period up to 4 years. An APA would be binding the taxpayer and the relevant tax authorities.

ii. Domestic Transfer Pricing

The Finance Act 2012⁹⁸ extended the scope of transfer pricing regulations to cover certain domestic transactions with associated parties within India.⁹⁹ Transactions with the aggregate value exceeding INR 50 million are covered and any expenditure for which payment is made or to be made to specified domestic related parties which *inter-alia* include a director, a relative of the director, a person having substantial interest in the taxpayer (carrying not less than 20% of the voting power) and related parties etc., will be required to be benchmarked at an arm’s length price and necessary compliance /documentations would have to be followed.

The 2015 Budget proposes to increase this limit of INR 50 million to INR 200 million.

II. Indirect Taxes

Various indirect taxes are levied at the central and state level. The government is taking steps to introduce a single Goods and Services Tax subsuming most indirect taxes to rationalize the indirect tax regime, to reduce the cascading effect of multiple taxes and to reduce administrative costs of compliance with multiple taxes.

Key indirect taxes levied currently are outlined below:

95. Supra n _____

96. [2008] 19 SOT 257 (DELHI)

97. *Vodafone India Services Pvt. Ltd. v. Union of India*, writ petition No. 871 of 2014

98. _____

99. Section 92BA added by the Finance Act, 2012 defines “specified domestic transaction” being certain transactions between two resident associated enterprises which attract the provisions of Chapter X of ITA.

A. Service Tax

The service tax regime has changed drastically with the introduction of the negative list approach. Under this approach, all services, except those specified in the negative list and those specifically exempted, would be chargeable to service tax. As such the negative list prescribed does not exempt any specific e-commerce transaction. The service tax law provides that the tax shall be at a rate of 12.36% on the value of service provided or agreed to be provided in a taxable territory (i.e., India) by one person to another. Typically, the location of the receiver of service is treated as the place where service is rendered.¹⁰⁰ In case of online information and database access or retrieval services, it has been specifically provided that the services would be construed to be provided at the location of the service provider.

The 2015 Budget proposes to increase the rate of service tax to from 12.36% (inclusive of cesses) to 14%.

Additionally, it is pertinent to note that a) temporary transfer or permitting the use or enjoyment of any intellectual property right (“IPR”) and b) development, design, programming, customization, adaptation, up gradation, enhancement, implementation of information technology software are considered to be ‘declared services’ under section 65B of the Finance Act, 1994. As per this, a temporary transfer of a patent registered outside India would also be covered in this entry, and would be taxable if the place of provision of service of temporary transfer of IPR is in taxable territory i.e. India. However, transfer of an IPR in a foreign country should not be taxable in India.

B. Sales Tax

In India, there are two types of taxes on sale of goods. Central Sales Tax (“CST”), which is levied by the central government, is generally payable on the sale of goods in the course of inter-state trade or commerce at the rate of 2%; intra-state sale, is governed by the respective state Value Added Tax (“VAT”) legislations. VAT is levied at standard rates of 0%, 1%, 5%, and 14.5% for different goods, although there may be variations in some states. In case of VAT, tax credits are available on VAT paid on input goods procured by the dealer.

In the context of e-commerce transactions, sales tax is relevant with respect to sale of intangible goods. In this regard, the Supreme Court has held that intangible goods such as software put in a tangible media, technical knowhow and other IPRs are goods for the purpose of sales tax.¹⁰¹ It has also been held that the IP that has been incorporated on a media for the purpose of transfer and media cannot be split up. Therefore, sale of computer software falls within the scope of sale of goods and is taxable. Thus, CST as well as VAT may be applicable on the transfer of IP.

C. Customs Duty

Customs Act, 1962 governs the levy of customs duty, which can be either export duty or import duty. Customs duty is calculated is usually based on the percentage of ‘value’ called ‘assessable value’ or ‘customs value’.¹⁰² Under the Indian law, any fees paid as royalties or license fee must be added to the customs value. In case of embedded copyrightable software, the value of the software, only if invoiced separately, is added to the valuation of the equipment for purposes of customs duty. If not invoiced separately, it would be assumed to be included in the price of the equipment package and the duty would be levied accordingly. Further, licensee fee or royalty paid for use of certain trademarks along with imported goods are also to be valued. However, payments for the right to reproduce or re-distribute imported goods should not be added to the customs value.

D. Central Excise Duty

Excise duty which is governed by the Central Excise Act, 1944, is an indirect tax levied on goods manufactured in India. It is a duty collected by the central government on manufacture of ‘goods’ and is levied at the time of removal from the factory. Under this, a payment towards any kind of IP is chargeable to the valuation of the goods. Valuation of the goods includes the value of engineering, development, artwork, design work and plans and sketches undertaken elsewhere than in the factory of production and is necessary for the production of such goods.¹⁰³ Excise duty on such goods is based on the sale price of the goods. However, it must be noted that excise duty is exempt on customized software but is payable on non-customized software which originates in India.

100. Place of provision of services, 2012

101. Anraj 61 STC 165 (SC)

102. Section 14(1) of the Customs Act, 1962 or tariff value under Section 14(2) of the Customs Act, 1975

103. Pawan Biscuits Co. Pvt Ltd v. CCE, (Patna), (2000) 120 ELT 24 (SC)

13. Conclusion

The rapid pace of growth of the e-commerce industry is not only indicative of the increasing receptiveness of the public but has also brought to the fore the issues that the legal system of the country has been faced with.

From the initial years when internet was a new phenomenon to recent times where internet has become a basic necessity for every household in most metropolitan cities, the e-commerce industry has come a long way. The legal system has constantly tried to catch up especially with the enactment of the various rules under the IT Act to deal with a host of issues emerging from the use of internet. Moreover the IP issues in e-commerce transactions have taken a new form with users finding loop holes to not only easily duplicate material but also mislead other users. Hence, much more is needed to effectively regulate the tangled web.

Therefore an in-depth understanding of the legal regime and the possible issues that an e-commerce business would face coupled with effective risk management strategies has been the need of the hour for e-commerce businesses to thrive in this industry.

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