आयकर अपीलीय अधीकरण, न्यायपीठ –"A" कोलकाता,
IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH: KOLKATA
(समक्ष)श्री पी. एम.जगताप, लेखा सदस्य **एवं** श्री ए.टी. वर्की,न्यायिक सदस्य)
[Before Shri P.M. Jagtap, AM & Shri A. T. Varkey, JM]

I.T.A. No. 677/Kol/2014
Assessment Year: 2008-09

Organon (India) Pvt. Ltd. (PAN: AAACI6949R)	Vs.	Deputy Commissioner of Income-tax, Circle-12, Kolkata.
Appellant		Respondent

&

I.T.A. No. 751/Kol/2014
Assessment Year: 2008-09

Deputy Commissioner of Income-tax, Circle-12, Kolkata.	Vs.	Organon (India) Pvt. Ltd.
Appellant		Respondent

Date of Hearing	07.06.2018
Date of Pronouncement	14.08.2018
For the Assessee	Shri Anubhav Rustogi, AR
For the Revenue	Shri Sanjay Mukherjee, Addl. CIT

ORDER

Per Shri A.T.Varkey, JM

These are cross appeals preferred by the assessee and the revenue against the order of the Commissioner of Income Tax (Appeals)-XII, Kolkata dated 10.01.2014 for Assessment Year 2008-09.

2. At the outset itself, the Ld. AR of the assessee has brought to our notice that the sole issue which the assessee assails is in respect of disallowance of Rs.15,66,910/- made by AO u/s. 40(a)(i) of the Income-tax Act, 1961 (hereinafter referred to as the "Act") for non-deduction of tax u/s. 195 of the Act on Microsoft license fee payable to Organon NV (AE). According to the Ld. AR, the precise issue cropped up in AY 2003-04 wherein also similar action was done by the AO and confirmed by the Ld. CIT(A) was challenged before this

Tribunal in ITA No. 863/Kol/2008 (AY 2003-04) and ITA No. 978/Kol/2009 (AY 2004-05) wherein the Tribunal vide order dated 20.09.2017 has allowed the appeal of the assessee on this issue and drew our attention to the grounds of appeal preferred before the Tribunal, which we find it to be the identical as that which has been preferred before us. We note that the Tribunal has gone extensively into the question raised before the Tribunal from para 14 to 19.2 wherein the Tribunal was pleased to allow the appeal of the appellant/assessee. The Ld. DR could not controvert before us that this issue is no longer res integra. We note that the Tribunal has decided the issue by observing as under:

> "14. On hearing rival contentions, we hold as follows:-
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> The assessee has paid an amount to Organon NV Netherlands, which is undisputedly an AE of the assessee company. The AE purchased software on license from Microsoft U.S.A. for use of its group entities. The expenditure incurred by the AE towards the purchase of this software is claimed to have been apportioned by it between all the group companies. The assessee company is using this software. The payment for this software was made to the AE by the assessee company without deduction of tax at source u/s 195 of the Act.
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> 14.1. The first issue that has to be adjudicated is whether the payment in question is royalty. It is not the case of the revenue that it is FTS or FIS, i.e., Fee for technical services or fee for included services. The case of the assessee is that the payment in question is not towards royalty. Reliance was placed on the judgement of the Hon'ble Delhi High Court in the case of *Director of income tax vs. Nokia networks OY (Supra).*
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> 14.2. The revenue relies on the judgement of the honourable Karnataka High Court in the case of *CIT vs. Samsung Electronics Company Ltd. (Supra)*
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> 14.3. The Hon'ble Delhi High Court in the case of *Director of income tax vs. Nokia networks OY (Supra),* held as follows [Head Notes]:-
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> ***"Income deemed to accrue or arise in India—Software—Royalty—Business connection/Permanent Establishment—Assessee, a company incorporated in Finland was a leading manufacturer of advanced GSM equipment—It maintained a Liaison Office (LO) and also had a subsidiary in India, NIPL—Assessee sold GSM equipment (Hardware as well as software as well as installation and commissioning of the two and also after sale services) manufactured by it in Finland to Indian telecom operators from outside India on a principal to principal basis, under independent buyer-seller arrangements—Installation activities were undertaken by Indian subsidiary under its independent contracts with Indian telecom operators—AO and CIT(A) held that LO and Indian subsidiary constituted assessee's PE in India and part of the revenue was attributable to PE and the whole of software revenue was assessed as "royalty" under s. 9(1)(vii) and Article 13—Tribunal granted partial relief to both assessee and Revenue—Held, LO has not carried out any business activity for the assessee in India, its role has been only to assist assessee in the preliminary and preparatory work—LO has only carried out advertising activity which cannot by any means furnish business connection—Even by law, the LO was prohibited in engaging itself in any business activities in India on behalf of the foreign enterprise, which could be considered to furnish a business connection in India—LO does not constitute assessee's PE in India—Further for taxing the profits for supply of equipment, place of negotiation, the place of signing of agreement or formal acceptance thereof or overall responsibility of the assessee are irrelevant circumstances—Since the***

transaction relates to the sale of goods, the relevant factor and determinative factor would be as to where the property in the goods passes—In instant case goods were manufactured outside India and even the sale has taken place outside India, property on goods passed on high seas—Supply has to be segregated from the installation and only then would question of apportionment arise to the determine the extent to which it arises in s. 9(1)(i)—Reliance placed by revenue on retrospective amendment of s. 9 was also misplaced—Assessee opted to be assessed by DTAA, the consideration cannot be assessed as "royalty" despite the retrospective amendments to the Act—In view of decision of Delhi High court in DIT v Ericsson AB, consideration for supply of software was not taxable as 'royalty' either under s. 9(1)(vi) or the relevant provision of the DTAA—Order of the Tribunal that 'NIPL' was a permanent establishment of assessee was based on many factual errors—Matter remitted to AO to consider this issue—Assessee's appeal partly allowed"

14.4. The ITAT Delhi 'A' Bench of the Tribunal in the case of *Aspect Software Inc.* ***vs.*** *ADIT, Circle 1(1), International Taxation,* while adjudicating a similar issue, discussed various case laws and has held as follows:-

"38. In the case of Ericsson, the Hon'ble Delhi High Court was dealing with a question as to whether the Tribunal was justified in holding that the consideration for supply of software was not a payment by way of royalty, and hence was not assessable both under Sec.9(1)(vi) of the Act and the relevant clause of DTAA with Sweden. The facts of the aforesaid case were that the assessee company was incorporated in Sweden and was one of the leading suppliers of telecommunication equipment comprising of both, hardware and software. The assessee company had entered into agreements with ten cellular operators in India for supply of hardware and software. The Assessing Officer was of the view that the income of the assessee was taxable in India, both, under the Income-tax Act, 1961 as well as under the treaty between India and Sweden. He held that it was business income and Assessee had a PE in India. The CIT(A) held that the receipts in respect of license to use software which is part of the hardware alone could be taxed in India as royalty. The Assessee argued before the Tribunal that the payment made by the assessee for the use of software in the equipment does not amount to royalty. The Tribunal in the aforesaid context examined the issue as to whether the payment is for a copyright or for a copyrighted article. If it is for copyright, it should be classified as royalty, both under the Income-tax Act and under the DTAA and it would be taxable in the hands of the assessee on that basis. If the payment is really for a copyrighted article, then it only represents the purchase price of the article and, therefore, cannot be considered as royalty either under the Act or under the DTAA. The Tribunal after referring to definition of Royalty under the Act and the definition copyright under the Copyright Act, 1957 held that what was sold by the non- resident was a copyrighted article and payment to the non-resident was not for copyright. On further appeal by the Revenue, the Hon'ble Delhi High Court held that income did not accrue to the non-resident by virtue of a business connection in India and therefore the question of the Nonresident having a permanent establishment in India did not arise for consideration at all. On the issue whether the payment to the non resident was of the nature of royalty which could be brought to tax in India, the Hon'ble Delhi High Court held as follows:

"WHETHER THE INCOME FROM THE SUPPLY CONTRACT CAN BE TREATED AS 'ROYALTY' UNDER SECTION 9(1)(vi) OF THE ACT:

50. Section 9 (1) (i) of the Act which deals with the taxability of "royalty income" reads as under:-

"Section 9 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA.

(1) The following incomes shall be deemed to accrue or arise in India :-

(i) All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India"

51. The submission of Mr. Prasaran, learned ASG was that software part of the equipment supply would attract royalty as copy right of the said software programme still vests with the assessee. Therefore, payments made for the licence to use the software programme give rise to "royalty" for the purposes of both the Income-Tax Act as well as DTAA entered into between Sweden and India. Referring to Explanation-II (v) to Section (1) (vi) of the Act as well as Article 13, para-3 of DTAA, it was argued that for the purposes of Income-Tax law, royalty is essentially a payment received as consideration for the use or right to use a particular integral property right, whether partially or entirely.

52. We find that the Tribunal has held that there was no payment towards any royalty and this conclusion is based on the following reasoning:-

(i) Payment made by the cellular operator cannot be characterized as royalty either under the Income Tax Act or under the DTAA.

(ii) The operator has not been given any of the seven rights under S.14 (a) (i) to (vii) of the Copyright Act, 1957 and, therefore what is transferred is not a copyright but actually a copyrighted article

(iii) The cellular operator cannot commercially exploit the software and therefore a copyright is not transferred.

(iv) Further, the parties to the agreement have not agreed upon a separate price for the software and therefore it is not open for the income tax authorities to split the same and consider part of the payment for software to be royalty

(v) The bill of entry for importing of goods shows that the price has been

separately mentioned for software and that this was only for the purposes of customs. There is no evidence to show that the assessee was a party to the fixation of value for the customs duty purposes

(vi) The software provided under the contract is goods and therefore no royalty can be said to be paid for it.

53. Mr. Prasaran, countered the aforesaid reasoning arguing that Clause 20 of the Supply Contract uses the term "licence" and the same term is used in the context of software throughout the three Agreements, indicating that it is not an outright sale of goods, or a full transfer of rights from the assessee to the Indian company. He also submitted that the software is a computer programme, which is treated differently from a book, not only in the Copyright Act, 1957 but also the Income Tax Act itself. His submission was that Section 52(1) (aa) of the Copyright Act only deems that certain acts will not to amount to infringement in the light of various concerns, where otherwise such acts would amount to infringement under Section 51 of the Copyright Act. The provision cannot by itself be used to hold that no right exists in the first place, since the scope of the right has to be understood only from the provisions of Section 14 of the Copyright Act, 1957. He also argued that the ITAT has misinterpreted the provisions of the DTAA, specifically Article 13, para 3 of the DTAA (Article 12, para 3 of the Model Convention) which defines royalties to mean "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work". The ITAT, it was submitted, has not appreciated that the

royalty is for the use or right to use any copyright. According to him, since title of the software continued to vest with the assessee as provided in clause 20.2 of the Supply Agreement and the assessee was free to grant non exclusive licenses to other parties, it follow that there was no full time transfer of copyright but it was only a case of right to use the software, and thus payment for use of software is to be treated as royalty. He further argued that reference to OECD Commentary was not apposite as it could not be used to interpret the scope of the relevant provisions of DTAA.

54. It is difficult to accept the aforesaid submissions in the facts of the present case. We have already held above that the assessee did not have any business connection in India. We have also held that the supply of equipment in question was in the nature of supply of goods. Therefore, this issue is to be examined keeping in view these findings. Moreover, another finding of fact is recorded by the Tribunal that the Cellular Operator did not acquire any of the copyrights referred to in Section 14 (b) of the Copyright Act, 1957.

55. Once we proceed on the basis of aforesaid factual findings, it is difficult to hold that payment made to the assessee was in the nature of royalty either under the Income-Tax Act or under the DTAA. We have to keep in mind what was sold by the assessee to the Indian customers was a GSM which consisted both of the hardware as well as the software, therefore, the Tribunal is right in holding that it was not permissible for the Revenue to assess the same under two different articles. The software that was loaded on the hardware did not have any independent existence. The software supply is an integral part of the GSM mobile telephone system and is used by the cellular operator for providing the cellular services to its customers. There could not be any independent use of such software. The software is embodied in the system and the revenue accepts that it could not be used independently. This software merely facilitates the functioning of the equipment and is an integral part thereof. On these facts, it would be useful to refer to the judgment of the Supreme Court in TATA Consultancy Services v. State of Andhra Pradesh, 271 ITR 401 , wherein the Apex Court held that software which is incorporated on a media would be goods and, therefore, liable to sales tax. Following discussion in this behalf is required to be noted:-

"In our view, the term "goods" as used in Article 366(12) of the Constitution of India and as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. (supra). A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (In case of painting) or computer discs or cassettes, and marketed would become "goods". We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of paintings or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc. The software programmes have all these attributes."

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"In Advent Systems Ltd. v. Unisys Corpn, 925 F. 2d 670 (3rd Cir. 1991), relied on by Mr. Sorabjee, the court was concerned with interpretation of uniform civil code which "applied to transactions in goods". The goods therein were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". It was held :

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good. That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

56. A fortiorari when the assessee supplies the software which is incorporated on a CD, it has supplied tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty.

57. It is also to be borne in mind that the supply contract cannot be separated into two viz. hardware and software. We would like to refer the judgment of Supreme Court in CIT v. Sundwiger EMFG Co., 266 ITR 110 wherein it was held:

"A plain and cumulative reading of the terms and conditions of the contract entered into between the principal to principal i.e., foreign company and Midhani i.e., preamble of the contract, Part-I and II of the contract and also the separate agreement, as referred to above, would clearly show that it was one and the same transaction. One cannot be read in isolation of the other. The services rendered by the experts and the payments made towards the same was part and parcel of the sale consideration and the same cannot be severed and treated as a business income of the non-resident company for the services rendered by them in erection of the machinery in Midhani unit at Hyderabad. Therefore, the contention of the Revenue that as the amounts reimbursed by Midhani under a separate contract for the technical services rendered by a nonresident company, it must be deemed that there was a "business connection", and it attracts the provisions of Section 9(1)(vii) of the Income Tax Act cannot be accepted and the judgments relied upon by the Revenue are the cases where there was a separate agreement for the purpose of technical services to be rendered by a foreign company, which is not connected for the fulfillment of the main contract entered into principal to principal. This is not one such case and thus the contention of the Revenue cannot be accepted in the circumstances and nature of the terms of the contract of this case."

58. No doubt, in an annexure to the Supply Contract the lump sum price is bifurcated in two components, viz., the consideration for the supply of the equipment and for the supply of the software. However, it was argued by the learned counsel for the assessee that this separate specification of the hardware/software supply was necessary because of the differential customs duty payable.

59. Be as it may, in order to qualify as royalty payment, within the meaning of Section 9(1) (vi) and particularly clause (v) of Explanation-II thereto, it is necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copy right of a literary, artistic or scientific work. Section 2 (o) of the Copyright Act makes it clear that a computer programme is to be regarded as a "literary work". Thus, in order to treat the consideration paid by the cellular operator

as royalty, it is to be established that the cellular operator, by making such payment, obtains all or any of the copyright rights of such literary work. In the presence case, this has not been established. It is not even the case of the Revenue that any right contemplated under Section 14 of the Copyright Act, 1957 stood vested in this cellular operator as a consequence of Article 20 of the Supply Contract. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article".

60. Mr. Dastur is right in this submission which is based on the commentary on the OECD Model Convention. Such a distinction has been accepted in a recent ruling of the Authority for Advance Ruling (AAR) in Dassault Systems KK 229 CTR 125. We also find force in the submission of Mr. Dastur that even assuming the payment made by the cellular operator is regarded as a payment by way of royalty as defined in Explanation 2 below Section 9 (1) (vi), nevertheless, it can never be regarded as royalty within the meaning of the said term in article 13, para 3 of the DTAA. This is so because the definition in the DTAA is narrower than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case.

61. We thus hold that payment received by the assessee was towards the title and GSM system of which software was an inseparable parts incapable of independent use and it was a contract for supply of goods. Therefore, no part of the payment therefore can be classified as payment towards royalty."

39. Similar view is expressed by the Hon'ble Jurisdictional High Court in the case of Nokia Networks OY (supra).

40. As far as the cases where only the software is separately licensed (i.e. with respect to 8 out of 63 customers to whom the assessee has licensed only the software), the issue is squarely covered by the decision of the Hon'ble Jurisdictional High Court in the case of Infrasoft Ltd. (supra), wherein their Lordships held as under:—

"86. The Licensing Agreement shows that the license is non-exclusive, nontransferable and the software has to be uses in accordance with the agreement. Only one copy of the software is being supplied for each site. The licensee is permitted to make only one copy of the software and associated support information and that also for backup purposes. It is also stipulated that the copy so made shall include Infrasoft's copyright and other proprietary notices. All copies of the Software are the exclusive property of Infrasoft. The Software includes a licenceauthorisation device, which restricts the use of the Software. The software is to be used only for Licensee's own business as defined within the InfrasoftLicence Schedule. Without the consent of the Assessee the software cannot be loaned, rented, sold, sublicensed or transferred to any third party or used by any parent, subsidiary or affiliated entity of Licensee or used for the operation of a service bureau or for data processing. The Licensee is further restricted from making copies, decompile, disassemble or reverse-engineer the Software without Infrasoft's written consent. The Software contains a mechanism which Infrasoft may activate to deny the Licensee use of the Software in the event that the Licensee is in breach of payment terms or any other provisions of this Agreement. All copyrights and intellectual property rights in and to the Software, and copies made by Licensee, are owned by or duly licensed to Infrasoft.

87. In order to qualify as royalty payment, it is necessary to establish that there is transfer of all or any rights (including the granting of any licence) in respect of copyright of a literary, artistic or scientific work. In order to treat the consideration paid by the Licensee as royalty, it is to be established that the licensee, by making such payment, obtains all or any of the copyright rights of such literary work. Distinction has to be made between the acquisition of a "copyright right" and a copyrighted article".

Copyright is distinct from the material object, copyrighted. Copyright is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. Just because one has the copyrighted article, it does not follow that one has also the copyright in it. It does not amount to transfer of all or any right including licence in respect of copyright. Copyright or even right to use copyright is distinguishable from sale consideration paid for "copyrighted" article. This sale consideration is for purchase of goods and is not royalty.

88. The license granted by the Assessee is limited to those necessary to enable the licensee to operate the program. The rights transferred are specific to the nature of computer programs. Copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilizing the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analyzing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business income in accordance with Article 7.

89. There is a clear distinction between royalty paid on transfer of copyright rights and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the royalty definition. Viewed from this angle, a non-exclusive and nontransferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of DTAA. Where the purpose of the licence or the transaction is only to restrict use of the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. The parting of intellectual property rights inherent in and attached to the software product in favour of the licensee/customer is what is contemplated by the Treaty. Merely authorizing or enabling a customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to transfer of rights in relation to copyright or conferment of the right of using the copyright. The transfer of rights in or over copyright or the conferment of the right of use of copyright implies that the transferee/licensee should acquire rights either in entirety or partially co-extensive with the owner/ transferor who divests himself of the rights he possesses pro-tanto."

14.5. The Hon'ble Karnataka High Court in the case of*COMMISSIONER OF INCOME TAX & ANR. VS. SAMSUNG ELECTRONICS CO. LTD. & ORS. (Supra),* held as follows [Head Notes]:-

"TDS—Payment to non-resident—Payment to foreign software suppliers for purchase of shrink wrapped software—What is granted under the licence is only a licence to use the software for internal business without having any right for making any alteration or reverse engineering or creating sub-licences while the copyright continues to be with the non-resident as per the agreement—Even as per the agreements entered into with other distributors as also the end-user licence agreement, except as expressly set forth in the agreement, the distributor cannot rent, lease, loan, sell or otherwise distribute the software, documentation or any derivative works based upon the software or documentation in whole or in part—Thus, licence is granted for making use of the copyright in respect of shrink wrapped software/off-the-shelf software under the respective agreements which authorizes the end-user i.e., customer to make use of the copyright in the said software—Hence, the contention of the assessee that there is no transfer of copyright or any part thereof under the agreements entered into by the assessee with the non-resident cannot be accepted—But for the licence granted to the assessee to make copy of the

software into the hard disk of the designated computer and to take a copy for back up purposes, the end-user has no other right and the said back up would have constituted an infringement of copyright—Right to make copy of the software itself is a part of copyright—What is transferred is the right to use the software, an exclusive right which the owner of the copyright i.e., the supplier owns—Thus, the amount paid to the non-resident supplier towards the supply of shrink wrapped software or off-the shelf software is not the price of CD alone or software alone or the licence but a combination of all—Therefore, the payments constitute 'royalty' within the meaning of art. 12(3) of the Indo-US DTAA and also as per the provisions of s. 9(1)(vi) as the definition of 'royalty' under s. 9(1)(vi) is broader than that under the DTAA—Consequently, assessee was under obligation to deduct tax at source under s. 195 from the amount paid to the foreign software suppliers"

14.6. We prefer to follow the propositions of law laid down by the Hon'ble Delhi High Court on this issue. The Hon'ble Supreme Court in the case of *CIT vs. Vegetable Products Ltd. [1973] 88 ITR 192(SC),* held that when two interpretations and views are possible on an issue, then the view in favour of the assessee has to be applied. Hence we hold that the payment in question was for use of a copyrighted article and not for the copyright itself.

Thus, the payment is not royalty. It is payment towards purchases. It would be assessable as business profits in the hands of the AE. As the AE does not have a permanent establishment in India, the business profits in question cannot be taxed in India, under Article 7 of the Indo-Netherlands DTAA. Thus, there is no element of income taxable in the hands of the AE, in India, on this transaction of payment for the use of licensed software from Microsoft. When there is no element of income taxable in India in the hands of the AE, on the remittance made towards purchase of licensed software for use by the assessee, there is no legal requirement for the assessee to deduct tax at source u/S 195 of the Indian Income Tax Act, 1961.

This proposition of law was laid down by the Hon'ble Supreme Court in the case of *GE India Technology Centre P Ltd. vs. CIT & Another (2010) 327 ITR 456 (SC),* wherein it is held as follows [Head Notes]:-

"TDS—Payment to non-resident—Obligation to deduct tax vis-a-vis taxability of remittance—Most important expression in s. 195(1) consists of the words "chargeable under the provisions of the Act"—Payer is bound to deduct tax at source only if the sum paid is assessable to tax in India—A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the IT Act—Sec. 195 also covers composite payments which have an element of income embedded or incorporated in them—Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct tax in respect of such composite payments—However, obligation to deduct tax is limited to the appropriate proportion of income which is chargeable under the Act—This obligation flows from the said words used in s. 195(1)—Sec. 195(2) pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted but is not sure as to what should be the portion so taxable or the amount of tax to be deducted—In such a situation he is required to make an application to ITO(TDS) for determining the amount—It is only when these conditions are satisfied that the question of making an order under s. 195(2) arises—If the contention of the Department that the moment there is remittance the obligation to deduct tax arises is to be accepted, then the words "chargeable under the provisions of the Act" in s. 195(1) would stand obliterated—If the

contention of the Department is accepted then the Department would be entitled to appropriate the moneys deposited by the payer even if it is not chargeable to tax because there is no provision in the Act whereby a payer can obtain refund—Sec. 237 r/w s. 199 implies that only the recipient of the sum can seek a refund—Thus, the interpretation of the Department leads to an absurd consequence—Entire basis of the Department's contention is based on administrative convenience in support of its interpretation—There are adequate safeguards in the Act which would prevent revenue leakage

14.7. Respectfully applying the propositions of law laid down in this case to the facts of our case, we hold that there is no violation of Section 195 of the Act by the assessee. Hence, the disallowance made under section 40(a)(i) of the Act is bad in law. Hence we delete the disallowance on this ground alone.

14.8. Even otherwise, the assessee invokes the Non Discrimination Clause under Article 24of the India-Netherland DTAA.

The said Article 24(4) reads as follows:-

4. Except where the provisions of paragraph 1 of Article 9, paragraph 9 of Article 11, or paragraph 9 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of one of the States to a resident of the other State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of one of the States to a resident of the other State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

14.9. Paraphrasing the above, Article 24(4) applies when the following conditions are satisfied:

- Interest, royalties and other disbursements are paid;
- These payments are made by an "enterprise" of a Contracting State i.e. Payer.
- The payee is a "resident" of the other Contracting State;
- For the purpose of determining the taxable profits in that state, of such enterprise which is the payer, this clause comes into operation.
- Article 9(1), 11(9) or 12(9) does not apply to such interest, Royalty etc.

In such circumstances, interest, royalties and other disbursements shall be deductible in the hands of the payer while determining the taxable profits of the enterprise in that State i.e. India in this case, under the same conditions as if they had been paid to a resident of that state.

15. The Hon'ble Delhi High Court was considering an identical Article, wherein, the assessee claimed relief under Article 26(3) of the India-U.S.A DTAA, in the case of *Herbalife International (P) Ltd.,* answered the question in favour of the assessee.

This Article reads as follows:-

"Article 26(3):- Where the provisions of paragraph 1 of Article 9 associated Enterprises), paragraph- 7 of Article 11 (interest) of paragraph- 8 of Article 12 (royalties and fees for included service) apply, interest, royalties and other disbursements paid by a resident to a Contracting State to resident of other Contracting State shall for the purposes of determining taxable profit of the first mentioned resident, be deductible under the same conditions as if they had been paid to a resident of first mentioned state."

The Hon'ble Delhi High Court held as follows:-

"38. The question that next arises is whether the payment by the Assessee to HIAI qualifies as 'other disbursements' for the purpose of Article 26 (3) DTAA?

39. To recapitulate, the case of the Revenue is that the expression 'other disbursements' should take colour from the context and would apply only to income which is of passive character just like interest and royalties. The Revenue invokes the doctrines of 'noscitur-a-sociis' and 'ejusdem generis'. It is submitted that FTS does not qualify as 'other disbursements' since it is not a passive character like royalties and interest.

40. The Court is unable to agree with the above submissions of the Revenue. In the context of which the expression 'other disbursement' occurs in Article 26 (3), it connotes something other than 'interest and royalties'. If the intention was that 'other disbursements' should also be in the nature of interest and royalties then the word 'other' should have been followed by 'such' or 'such like'. There is no warrant, therefore, to proceed on the basis that the expression 'other disbursements' should take the colour of 'interest and royalties'.

41. The expression 'other disbursements' occurring in Article 26 (3) of the DTAA is wide enough to encompass the administrative fee paid by the Assessee to HIAI which the Revenue has chosen to characterize as FTS within the meaning of Explanation 2 to Section 9 (1) (vii) of the Act.

42. At one stage of the proceedings, the Assessee sought to contend that the payment was FIS covered under Article 12 (4) of the DTAA. The ITAT did not address this issue. It addressed the question whether, even assuming it was FIS, Section 40 (a) (i) of the Act cannot be applied and consequently, no disallowance can be made. Before this Court no question has been framed at the instance of the Assessee that the payment is covered by Article 12 (4) of the DTAA. Consequently, this question is not examined by the Court.

"46. Section 40 is in the nature of a non-obstante provision and therefore, it overrides the other provisions as contained in Sections 30 to 38 of the Act. This means that the expenditure which is allowable under Sections 30 to 38 of the Act in computing business income would be subject to deductibility condition in Section 40 of the Act. The payment of FTS to HIAI would be allowable in terms of Section 37 (1) of the Act but before such payment can be allowed the condition imposed in Section 40 (a) (i) of the Act regarding deduction of TDS has to be complied with. In other words if no TDS is deducted from the payment of FTS made to HIAI by the Assessee, then in terms of Section 40 (a) (i) of the Act, it will not be allowed as a deduction under Section 37 (1) of the Act for computing the Assessee's income chargeable under the head 'profits and gains of business'.

47. Article 26(3) of the DTAA calls for an enquiry into whether the above condition imposed as far as the payment made to HIAI, i.e., payment made to a non-resident, is any different as far as allowability of such payment as a deduction when it is made to a resident.

48. Section 40 (a) (i) of the Act, as it was during the AY in question i.e. 2001-02, did not provide for deduction in the TDS where the payment was made in India. The requirement of deduction of TDS on payments made in India to residents was inserted, for the first time by way of Section 40 (a) (ia) of the Act with effect from 1st April 2005. Then again as pointed out by Mr. M.S. Syali, learned Senior Advocate for the Intervener, Section 40 (a) (ia) refers only to payments of interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a ITA No. 7/2007 Page 27 of 35 contractor or sub-contractor' etc. It does not include an amount paid towards purchases.

Correspondingly, there is no requirement of TDS having to be deducted while making such payment.

49. However, the element of discrimination arises not only because of the above requirement of having to deduct TDS. The OECD Expert Group which brought out a document titled 'Application and Interpretation of Article 24(Non- Discrimination), Public discussion Draft, May 2007 did envisage deduction of tax while making payments to non-residents. It is viewed only as additional compliance of verification requirement which would not attract the non- discrimination rule. The OECD Expert Group noted that the non-discrimination obligation under tax conventions is restricted in scope when compared with equal treatment or nondiscrimination clauses in an investment agreement." Specifically, in relation to withholding taxes, the Expert Group in the note by its chairman titled "Non-Discrimination in Bilateral Tax Conventions' noted as follows"

"6. The more limited non-discrimination obligations in tax conventions reflect the practical problems of cross-border taxation. For example, countries frequently collect taxes from non-residents through a system of withholding at source. Withholding is most frequently imposed on passive income, such as dividends, interest, rents, and royalties. Because the recipient may have no connection with the country of source other than the investment generating the income, withholding at the time of payment is likely to be the only realistic opportunity for the source country to collect its tax. Withholding is often not required on payments to residents. However, the application of withholding tax systems is appropriate. Residents have substantial economic connections with their country of residence; so that country is likely to have ample opportunity to collect its tax later, when a tax return is filed. Non-residents may be beyond the collection jurisdiction of the taxing country."

50. While the above explanation provides the rationale for insisting on deduction of TDS from payments made to non-resident, the point here is not so much about the requirement of deduction of TDS per se but the consequence of the failure to make such deduction. As far as payment to a non-resident is concerned, Section 40 (a) (i) of the Act as it stood at the relevant time mandated that if no TDS is deducted at the time of making such payment, it will not be allowed as deduction while computing the taxable profits of the payer. No such consequence was envisaged in terms of Section 40 (a) (i) of the Act as it stood as far as payment to a resident was concerned. This, therefore, attracts the non-discrimination rule under Article 26 (3) of the DTAA.

51. The arguments of counsel on both sides focussed on the expression 'same conditions' in Article 26(3) of the DTAA. To recapitulate, a comparison was drawn by learned counsel for the Revenue with Article 26(1) which speaks of preventing discrimination on the basis of nationality and which provision employs the phrase 'same circumstances'. Article 26 (2) which talks of prevention of discrimination vis-a-vis computing tax liability of PEs and employs the expression 'same activities'. The expression used in Article 26 (3) is 'same conditions'. Learned counsel for the Revenue sought to justify the difference in the treatment of payments made to non-residents by referring to Article 14 of the Constitution of India and contended that the line of enquiry envisaged examining whether (a) the classification was based on an intelligible differentia and (b) whether the classification had a rational nexus with the object of the statute.

52. Section 40 (a) (i), in providing for disallowance of a payment made to a non-resident if TDS is not deducted, is no doubt meant to be a deterrent in order to compel the resident payer to deduct TDS while making the payment. However, that does not answer the requirement of Article 26 (3) of the DTAA that the payment to both residents and non-residents should be under the 'same conditions' not only as regards deduction of TDS but even as regards the allowability of such payment as deduction.

It has to be seen that in those 'same conditions' whether the consequences are different for the failure to deduct TDS.

53. It is argued by the Revenue that since in the present case no condition of deduction of TDS was attracted, in terms of Section 40 (a) (i) of the Act as it then stood, to payments made to a resident, but only to payments made to non-residents, the two payments could not be said to be under the 'same condition'. The further submission is that if they are not made under the same condition', the non-discrimination rule under Article 26 (3) of the DTAA is not attracted.

54. In the first place it requires to be noticed that DTAA is as a result of the negotiations between the countries as to the extent to which special concessional tax provisions can be made notwithstanding that there might be a loss of revenue. In Union of India v. AzadiBachaoAndolan (supra) the Supreme Court noted that treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient quid pro quo is obtained by both sides.' The Court acknowledged that developing countries allow 'treaty shopping' to encourage capital and technology inflows which developed countries are keen to provide to them. It was further noted that the corresponding loss of tax revenues could be insignificant compared to the other non-tax benefits to the economies of developing countries which need foreign investment. The Court felt that this was a matter best left to the discretion of the executive as it is dependent upon several economic and political considerations.

55. Consequently, while deploying the 'nexus' test to examine the justification of a classification under a treaty like the DTAA, the line of enquiry cannot possibly be whether the classification has nexus to the object of the 'statute' for the purposes of Article 14 of the Constitution of India, but whether the classification brought about by Section 40 (a) (i) of the Act defeats the object of the DTAA."

A perusal of the wordings of Article 24(4) of the Indo-Netherlands DTAA and the wordings of Article 26(3) of the India-U.S. DTAA brings us to a conclusion that the propositions of law laid down by the Hon'ble Delhi Court in the case of *Herbalife India Pvt. Ltd. (supra)* applies to the facts of this case. Thus respectfully following the same, we decide the addition of ground raised by the assessee involving non discrimination, in favour of the assessee.

16. We now consider the arguments of the ld. DR, that the assessee falls within the provisions of paragraph 1 of Article 9 of the Indo-Netherlands DTAA and consequently, he would not be eligible for any relief under Article 24(4) of the Indo-Netherlands DTAA.

Article 9 of the Indo-Netherlands DTAA, reads as follows:-

1. Where—

(a)	*an enterprise of one of the States participates directly or indirectly in the management, control or capital of an enterprise of the other State, or*
(b)	*the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the States and an enterprise of the other State,*

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have

accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

A plain reading of this Article demonstrates that the conditions imposed are cumulative. The first condition is that an enterprise of one state participates directly or indirectly in the management, control or capital of the other state or that some person participates directly or indirectly in the management, control or capital of an enterprise of one of the states and the enterprise of the other state. And the second condition is that the commercial and financial relationship between these two enterprises should differ from that which would have been between two independent enterprises. In other words, this clause comes into effect only when transactions are between associated enterprises and are not made at arm's length. In other words, when transaction between associate enterprises are at arm's length, this clause does not come into play.

In the case on hand the impugned transaction of purchase of software from the AE was considered as a transaction at arm's length between AEs, by the TPO and consequently by the Assessing Officer. No Transfer Pricing adjustment has been made on these transactions. Thus, paragraph 1 of Article 9, does not apply to the facts of this case and consequently this issue does not fall within the exception to Article 24(4) of the Indo-Netherlands DTAA.

17. The Delhi Bench of the Tribunal in the case of *Honda Cars India Ltd. vs. DCIT (supra)*, where one of us was an author, had considered a similar issue and held that the there is no transfer pricing adjustment made by the TPO in an international transaction, then that transaction is not covered by Article 9 (1) of the DTAA. This view is fortified by the judgement of the Hon'ble Delhi High Court in the case of *Herbalife India Pvt. Ltd. (supra).*

17.1. Respectfully following the same reject the argument of the ld. DR, as devoid of merit.

18. As no deduction of tax need be made by the assessee for the similar payment made to a resident for the purchase of software during the impugned Assessment Years, the non discrimination clause under Article 24(4) of the Indo-Netherlands DTAA, applies to the facts of this case.

18.1. The reliance of the ld. DR in the case of *M/s. Andaman Sea Foods* is not correct as in that case, it was held that the DTAA between India and Singapore, does not apply and the decision has to be made under the Domestic law. Consequently, it was held that the issue in question was taxable even prior to the amendment introduced by the Finance Act 2010. The decision in the case of *Gramophone Company Of India Ltd. (supra)* does not deal with DTAA.

18.2. The argument of the ld. DR that DTAA cannot be invoked by a domestic company as its income is not taxable in two tax jurisdiction is also devoid of merit as the Article specifically talks about the determination of taxable income of a resident company only.

19. In view of the above discussion, applying the propositions of law laid down by the Hon'ble Delhi High Court in the case of *Herbalife International India (P) Ltd. (supra)* and the Co-ordinate Bench of the Tribunal in the case of *Honda Cars India Ltd. vs. DCIT (supra),* we allow this ground of the assessee and delete the disallowance made u/s 40(a)(i) of the Act.

19.1. As we have granted relief on this ground also, we do not adjudicate the other argument raised by the assessee, as it would be a mere academic exercise.

19.2. In the result, these grounds of the assessee are allowed."

3. Respectfully following the aforesaid order of the Tribunal we allow this ground of appeal of the assessee. Therefore, the appeal of assessee is allowed.

4. Coming to the revenue's appeal. We note that the only issue is against the action of the Ld. CIT(A) in deleting the expenses amounting to Rs.75,29,700/-, which according to the AO was capital in nature .

5. Brief facts of the case are that the assessee company was in the process of setting up of pharmaceutical factory on Kona land in West Bengal for expansion of its existing business. In the process of setting up factory an amount of Rs.75,29,700/- was incurred in respect of various expenses for initiation and setting up of the project. The expenses primarily included payment of engineering charges for design and drawing, fees paid for NOC and other related expenses. However, due to various financial and other technical constraints it was found that the project was not feasible. In order to avoid incurrence of any further loss, the management abandoned the project during the relevant previous year and accordingly, an amount of Rs.75,29,700/- was written off in the return of income filed and assessee claimed the said amount written off as a business deduction. The basis of making the claim was also disclosed in the computation of income. During the course of assessment proceedings the AO required the assessee to provide explanation in respect of allowability of such expenses as business deduction. Though the assessee filed detailed response vide its letter dated 22.12.2011, the AO did not accept the explanation offered by the assessee by observing as under:

> *"1) The expenses pertain to some previous year not relating to relevant Assessment Year, i.e., AY 2008-09. These expenses were not claimed as revenue expense in the said previous year and hence the assessee itself has claimed it as capital expense under the head capital work in progress. Once the expenses have been treated as capital expense the same cannot be treated as revenue expense just because no benefit could be derived from it.*
>
> *2) The same view was taken by Hon'ble Kolkata High Court in case of Hasimara Industries Ltd. -Vs.- CIT 231 ITR 842.*
>
> *3) The case laws relied upon by assessee is distinguishable on facts.*
>
> *4) The payments are in the nature of consulting fees for land and engineering fees for formulation plant. The payment was attracting TDS, which was not made by the assessee."*

6. Aggrieved, the assessee preferred an appeal before the Ld. CIT(A), who did not agree with the assessee's contention that the expenditure should be allowed as deduction

u/s. 37 of the Act. However, the Ld. CIT(A) found substance in the ground no. 7 wherein the assessee claimed the amount u/s. 28 of the Act as loss incidental to business and deleted the addition. Aggrieved, the revenue is before us.

7. We have heard rival submissions and gone through the facts and circumstances of the case. We note that the assessee had during the previous year incurred expenses on account of engineering charges, design and drawing expenses, fees paid for NOC for setting up of pharmaceutical factory at Kona land in West Bengal and for expansion of its factory on Kona land in West Bengal and for expansion of its existing business. We note that the expenses incurred by the assessee were for the expansion of the already existing unit and it was incidental to the assessee's business and the expenses were capitalized under work-in-progress. We note that the assessee abandoned the project being non-viable in the year under consideration. We note that the finding rendered by the Ld. CIT(A) that no asset of enduring nature was created to the assessee on the expenditure claimed by the assessee has been challenged by the Revenue before us. We note that in the facts and circumstances of the case, the Ld. CIT(A) is right in finding that the expenditure is incidental to the business carried out by the assessee and, therefore, the said expenditure is nothing but loss incidental to the assessee's business. It is well settled that profits and gains which are liable to be taxed u/s. 28 of the Act are what are understood to be such according to ordinary commercial principle. The word 'profit' is to be understood in its natural and proper sense – in a sense which no commercial man would misunderstand. We note that the Ld. CIT(A) has rightly allowed the claim made by the assessee as a deduction u/s. 28 of the Act by taking note of the Hon'ble Supreme Court decision in Ramchandran Shivnarayaan Vs. CIT 111 ITR 263 wherein the Hon'ble Supreme Court observed as under:

> *"It is to be remembered that the direct and proximate connection and nexus must be between business operations and the loss. It goes without saying that a business man has to keep money either when he gets it as sale proceeds of the stock in trade or for disbursement to meet the business expenses or for purchasing stock in trade and if he losses such money in the ordinary course of such business, the loss is a deductible trading loss. It is immaterial whether the money is a part of the stock in trade, such as, of a banking company or a money lender, or is directly connected with the other business operations. The risk is inherent in the carrying on of the business and is directly connected with it or incidental to it."*

8. Taking note of the ratio decidendi of the Hon'ble Supreme Court we note that the Ld. CIT(A) has rightly allowed the claim of the assessee u/s. 28 of the Act, which we

uphold and, therefore, dismiss the ground of appeal of the revenue. Therefore, the assessee's appeal is allowed and that of the revenue is dismissed.

9. In the result, assessee's appeal is allowed and that of the revenue is dismissed.

Order is pronounced in the open court on 14th August, 2018

Sd/-	Sd/-
(P. M. Jagtap)	(Aby. T. Varkey)
Accountant Member	Judicial Member

Dated :14th August, 2018

Jd.(Sr.P.S.)

Copy of the order forwarded to:

1. Appellant – M/s. Organon (India) Pvt. Ltd., Platina, 8th floor, Plot No. C-59, G-Block, Bandra Kurla Complex, Bandra (East), Mumbai-700 098, Maharastra.
2 Respondent – DCIT, Circle-12, Kolkat.
3. The CIT(A)-XII, Kolkata. (sent through e-mail)
4. CIT Kolkata.
5. DR, ITAT, Kolkata. (sent through e-mail)

/True Copy, By order,

Sr. Pvt. Secretary