

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH 'E' NEW DELHI**

**BEFORE  
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER  
AND  
SHRI ANADEE NATH MISSHRA, ACCOUNTANT MEMBER**

**ITA No.6693/Del/2016  
Assessment Year: 2013-14**

Mentor Graphics Ireland Ltd., B-29, 9 <sup>th</sup> floor, Himalaya House, 23, Kasturba Gandhi Marg, New Delhi-110001 (PAN: AAGCM6365H)	<b>vs</b>	ACIT(International Taxation), Circle 2(2)(1), Room No. 411, 4 <sup>th</sup> Floor, E-2 Block, Pratyaksh Kar Bhawan, Civic Centre, J.L. Nehru Marg, New Delhi-110002
Appellant		Respondent

**Appellant by: Shri Tarandeep Singh, Advocate  
Respondent by : Shri G.K. Dhall, CIT DR**

**Date of hearing : 29.08.2018  
Date of pronouncement : 26.11.2018**

**ORDER**

**PER SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER:**

The Assesse has filed this appeal, being aggrieved by the final order of assessment dated 31<sup>st</sup> October, 2016 passed by the ACIT, Circle 2(2)(1), International Tax, New Delhi u/s 144C(1)/143 of the Income Tax Act, 1961 (hereinafter called 'The Act'). Final order of assessment has been passed by the Assessing

Officer (AO) pursuant to the directions issued by Ld. Dispute Resolution Panel (DRP) vide order dated 6<sup>th</sup> September, 2016.

2.0 Briefly stated, the relevant facts are that the assessee is a company incorporated in Ireland and during the year under consideration it was in receipt of certain sum towards “Sale of Software” and “Provision for Support Services” from its Indian Distributors. It is undisputed that the amount received by the assessee from “Provision of Support Services” was been offered to tax on gross basis as per Article 12 of India-Ireland Double Taxation Avoidance Agreement (DTAA). It is also not in dispute that there is no Permanent Establishment (PE) of the assessee in terms of Article 5 of DTAA in India. In the present appeal, the dispute pertains to the taxability of amount received by the assessee from “Sale of Software”. During the course of assessment, the AO directed the assessee to submit as to why the receipts on account of “Sale of Software” may not be taxed as income from Royalty as per the provisions of section 9(1)(vi) of the Act and Article 12 of the Agreement for Avoidance of Double Taxation between India and Ireland. In response, the assessee submitted copies of Distributor Agreements executed by it with its Indian distributor and copies of End User Licence Agreements.

The assessee also submitted copies of invoices raised by it on its Indian Distributors. Before the AO, it was submitted by the Assessee that neither the Distributor nor the End User had a right to reverse engineer, reverse-compile or otherwise re-engineer software products. The incorporeal right to the software i.e., copyright remained with the Assessee and the same was not transferred in any way by the Assessee to its distributors or the End Users. It was submitted before the AO that the right to use a copyright in the programme was totally different from the right to use a programme embedded in a floppy/disk/CD/dongle which may be a software and the payment made for the same cannot be said to be have been received as consideration for the use of or right to use of any copyright to bring it within the definition of royalty as given in the DTAA. The Assessee further clarified and submitted that what the distributors acquired was only a copy of the copyrighted article and the copyright remained with it. In support of its claim, the assessee relied upon following judicial pronouncements:-

- (i) Director of Income tax vs. Infracsoft Ltd. reported in 220 Taxman 273 (Del)
- (ii) Commissioner of Income Tax Vs. Dynamic Vertical Software India (P) ltd. reported in 332 ITR 222 (Del)

- (iii) CIT vs M. Tech India P. Ltd. reported in 381 ITR 31(Del)
- (iv) CIT vs Ericsson A.B., reported in 343 ITR 470 (Del)
- (v) Dassault Systems K.K. reported in 322 ITR 125 (AAR)
- (vi) Novel Inc. vs. DDIT reported in 49 SOT 45 (Mum)
- (vii) M/s Capgemini Business Services (India) reported in 158 ITD 1(Mum)
- (viii) TII Team Telecom International Pvt. Ltd. reported in 47 SOT 76 (Mum) (URO)

2.1 The AO, however, was not convinced and in the proposed draft order of assessment he held that the assessee's receipts on account of "Sale of Software" was chargeable to tax as income from Royalty as defined under provisions of section 9(1)(vi) of the Act and Article 12 of the DTAA. In this regard, it was held by the AO as under:-

*"The assessee Company is Company based out of Ireland. As per Section 90 of the Income Tax Act, 1961 taxability of a non-resident is to be governed by the provisions of the Act or the DTAA whichever is more beneficial to the assessee.*

*Payments for software are anyways taxable under Section 9(1)(vi) of the Act. The intention of the legislature to tax software payments was made clear by way of amendments brought in the by Finance Act 2012 by way of insertion of Explanation 12 to Section 9(1)(vi) by which it was clarified*

*that transfer of all or any rights for use or right to use a computer software.*

*The assessee being a resident of Ireland is eligible to claim taxation under the DTAA if provisions of DTAA are not beneficial to assessee. The relevant DTAA in this case is India-Ireland DTAA. As per Article 12 of the DTAA, royalties means 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 including cinematograph films or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft or for information concerning industrial commercial or scientific experience.*

*According to the submissions made by the assessee the payments received for sale of software, without allowing any right to use the copyright in the software, would not be covered within the scope of 'royalty' under the DTAA. The assessee also submitted that the parting of intellectual property rights inherent in and attached to the software product in favor of the distributors is what is contemplated by the definition of 'royalty' provided in the DTAA. Merely authorizing the distributor to distributor the software products in India and enabling the end-customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to use of or right to use any copyright.*

*The above submissions of the assessee are not tenable since the definition of royalty under the DTAA covers not only the payment made for the right to use any copyright but also the payment made for the right to use any copyright. Therefore, consideration received from distributors is to be treated as royalty even under the DTAA as the definition covers the consideration received for the use of copyright.*

*Karnataka High Court in the case of Samsung Electronics Co. Ltd. (345 ITR 494) wherein the Hon'ble Karnataka High Court has held that payments made for software would be taxable as royalty even under the DTAA. The Hon'ble High Court held as under:-*

*"If is also clear from the above said analysis of the DTAA, Income-tax Act, Copyright Act that the payment would constitute 'royalty' within the meaning of Article 12(3) of the DTAA and even as per the provisions of section 9(1)(vi) as the definition of 'royalty' under section 9(1)(vi) is broader than the definition of 'royalty' under the DTAA as the right that is transferred in the instant case is the transfer of copyright including the right to make copy of software for internal business, and payment made in that regard would constitute 'royalty' for imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill as per clause (iv) of Explanation 2 to section 9(1)(vi). In any view of the matter, in view of the provisions of section 90, agreements with foreign countries (DTAA) would override the provisions of the Act. Once it is held that payment made by the assessee to the non-resident companies would amount to 'royalty' within the meaning of article 12 of the DTAA with the respective country, it is clear that the payment made by*

*the assessee to the non-resident supplier would amount to royalty”.*

*Similar view was upheld by Karnataka High Court in the case of Synopsis International Old Ltd. (212 Taxman 454) wherein the Court while dealing with taxability of software payments held as under:-*

*“It is no doubt true the provisions of the DTAA overrides the provisions of the Income-tax Act. In the DTAA the term ‘royalty’ means payments of any kind received as a consideration for the use or the right to use any copyright of literary, artistic or scientific work whereas in the Income-tax Act, royalty means consideration for the transfer of all or any rights including the granting of a license. Therefore, under the DTAA to constitute royalty there need not be any transfer of or any rights in respect of any copyright. It is sufficient if consideration is received for use of or the right to use any copyright. Therefore, if the definition of royalty in the DTAA is taken into consideration it is not necessary there should be a transfer of any exclusive right. A mere right to use or the use of a copyright falls within the mischief of Explanation (2) to clause (vi) of sub-section (1) of section 9 and is liable to tax. Therefore, there is no substance in the said contention.”*

*Similar view was also upheld by jurisdictional Delhi Tribunal in the case of Microsoft Corporation vs. ADIT (8 ITR 522) wherein the payments for software were held to be taxable as royalty both under the Act and the DTAA and the Authority for Advance Rulings in the rulings pronounced in the cases of Millennium IT Software Ltd. (338 ITR 391) and Citrix Systems Asia Pacific Pty Ltd. have held the payments for software taxable as ‘royalty’ in India.*

*The reliance placed by the assessee on the judgements of Delhi High Court in the case of Infracsoft Ltd., Dynamic Vertical Software India (P) Ltd. and M. Tech India P. Ltd. cannot be relied upon since the issue has not attained finality and the department has filed SLP in few cases and the decision of the Hon'ble Supreme Court is still pending.”*

2.2 Being aggrieved, the assessee filed objections before the Ld. DRP. The judicial precedents cited before the AO were reiterated. The Ld. DRP recorded that the tax department has preferred an appeal before Hon'ble Apex Court against the Jurisdictional High Court decisions relied upon by the assessee and since it is an authority which is part of the assessment process the issue in dispute has to be decided against the assessee in order to keep the matter alive. In this regard, it has been held by the Ld. DRP as under:-

*“The distributors of the assessee (M/s Mentor Graphics) receive the software and then transmit the same onwards to the customers. It is not demonstrated that such software is specific for the assessee as it is transferred online to the distributor who then passes it on to the clients from its computers. Similar transactions have been held to be in the nature of royalty by Hon'ble Karnataka High court in 345 ITR 494 in case of Samsung Electronics Co. Ltd.*

*Further, section 9(1)(vi), where term Royalty has been defined, deals with transactions of similar nature. The software revenue, received by the assessee, clearly falls within the definition as laid down in 9(1)(vi).*

*In view of the discussions supra, in addition to the rationale given by the AO in the draft assessment order, the panel is in agreement with the position of the AO. Accordingly, the action of the AO in this respect is upheld.*

*The Assessee has taken a plea about not being heard by the AO. That is now redundant as the matter has been heard by the DRP at length and the assessee has been afforded sufficient opportunity to make out its case. DRP, being an extension of the assessment process, has heard the assessee before reaching its conclusions. The assessee cannot now claim to non-availability of opportunity of being heard. This objection is hence dismissed.*

*The AO has also recorded that “The reliance placed by the assessee on the judgements of Delhi High Court in the case of Infrasoftware Ltd., Dynamic Vertical Software India (P) Ltd. and M. Tech India P. Ltd. cannot be relied upon since the issue has not attained finality and the department has filed SLP in few cases and the decision of the Hon’ble Supreme Court is still pending”. The departmental position is clear in this regard and the panel is part of assessment process. Therefore the issues in challenge before Hon’ble Apex Court need to be kept alive.*

*The objection of the assessee are dismissed in view of the foregoing.*

*In view of above discussion on each of the grounds of objection, the Assessing Officer is directed to complete the assessment as per the directions of the DRP as above.”*

2.3 The Assessee is now in appeal before us. Following grounds of appeal have been raised:-

*“1. On the facts and in the circumstances of the case and in law, the learned DRP/AO have erred in holding that the consideration received by the Appellant for supply/distribution of its copyrighted software to the Indian distributors qualifies as ‘royalty’ under section 9(1)(vi) of the Act as well as Article 12 of the India-Ireland Double Taxation Avoidance Agreement (DTAA).*

*2. On the facts and in the circumstances of the case and in law, the learned DRP/AO has erred in concluding that consideration received by the Appellant for supply / distribution of its copyrighted software is for grant of ‘right to use’ copyright in such software and hence, qualifies as royalty.*

*3. On the facts and in the circumstances of the case and in law, the learned DRP/AO erred in not following the principles laid down in judicial precedents cited by the Appellant, including the binding judgments rendered by the jurisdictional Hon’ble Delhi High Court.*

4. *Without prejudice to the grounds 1 to 3 above, on the facts and in circumstances of the case and law, the learned AO has erred in charging education cess on the tax rate as prescribed under India – Ireland DTAA.*

5. *On the facts and in the circumstances of the case and in law, the learned AO has erred in levying interest under section 234B of the Act.*

6. *On the facts and in the circumstances of the case and in law, the learned AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act against the Appellant.”*

3.0 During the course of hearing, Shri Tarandeep Singh, Ld. Counsel for the assessee submitted that the issue in dispute is directly covered in favour of the assessee by the decision of Hon’ble Jurisdictional High Court in the following cases :-

- (a) DIT vs. Infrasoftware Ltd. (supra)
- (b) DIT vs. Ericsson A.B. (supra)
- (c) DIT vs. Nokia Networks Oy reported in 358 ITR 259 (Del)

3.1 The Ld. AR further submitted that the decision of the Hon’ble Karnataka High Court in the case of CIT vs. Samsung Electronics reported in 203 Taxmann 477 (Kar) is not to be followed as the same is contrary to the decision of Hon’ble

Jurisdictional High Court cited by him. In this regard, the Ld. AR specifically referred to Para 98 & 99 of the decision of Hon'ble Jurisdictional High Court in the case of Infrasoftware Ltd. (*supra*) wherein the Hon'ble High Court has held that they are not in agreement with the decision of the Hon'ble Karnataka High Court. The Ld. AR further submitted that the reliance placed by the AO on the decision of Delhi Tribunal in the case of Microsoft Corporation (*supra*) is also not relevant as the said decision has been held to be bad in law by the Hon'ble Jurisdictional High Court in the case of Nokia Network Oy (*supra*). In this regard, the Ld. AR invited our attention to Para 23 of the decision in the case of Nokia Network (*supra*).

4.0 The Ld. CIT (DR), on the other hand, did not dispute the contentions raised by the Ld. AR. By placing reliance on the order passed by the lower authorities it was submitted by him that the view expressed by them does not require any interference by this Court.

5.0 We have carefully considered the facts of the case and the material available on record. There is no dispute as regards the facts of the case. After considering the facts of the case and the arguments of both the sides, we are of the opinion that the

issue is squarely covered in favour of the assessee by the decision of Hon'ble Jurisdictional High Court. In the case of Ericsson A.B., (supra), the Hon'ble Jurisdictional High Court has held as under:—

*"Once one proceeds 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 Act or under the DTAA. It is apparent that 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.*

*A fortiori 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.*

*It is also to be borne in mind that the supply contract cannot be separated into two viz., hardware and software.*

*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 assessee that this separate specification of the hardware/software supply was necessary because of the differential customs duty payable.*

*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 present 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 the supply contract. Distinction has to be made between the acquisition of a 'copyright right' and a 'copyrighted article'."*

5.1 Similar view is expressed by the Hon'ble Jurisdictional High Court in the case of Infrasoftware Ltd. (supra), wherein their Lordships held as under:—

"86. The Licensing Agreement shows that the license is non-exclusive, non-transferable and the software has to be used 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 Infrasoftware's copyright and other proprietary notices. All copies of the Software are the exclusive property of Infrasoftware. The Software includes a licence authorisation device, which restricts the use of the Software. The software is to be used only for Licensee's own business as defined within the Infrasoftware Licence 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 Infrasoftware's written consent. The Software contains a mechanism which Infrasoftware 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 Infrasoftware.

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 non-transferable 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."*

5.2 We find that treaty provisions between India and Ireland unambiguously require that the use of copyright is to be taxed in the source country. In the present case, the payment has been made by assessee for use of "copyrighted material" rather than for the use of copyright. The facts of the present case are identical with the facts before the Hon'ble Jurisdictional High Court. None of the lower authorities have factually doubted the contention of the assessee that it has received consideration for the transfer of a copyrighted product and not for the transfer of copyrights in the computer software programme. The distinction between the transfer of a copyright and the transfer of a copyrighted product is prominent. The sole contention of the AO and the Ld DRP is that the department is in appeal against the decisions of the Jurisdictional High Court before the Hon'ble Apex Court. The AO has relied upon the decision of the Hon'ble Karnataka High Court in case of Samsung Electronics (*supra*) and GracemacCorpn (*supra*). These decisions are not being considered as the issue is extensively dealt with by the Hon'ble Jurisdictional High Court in the cases of Ericsson A.B. and Infracsoft Ltd (*supra*) which are binding on this Tribunal. Once it is not in dispute that there is no transfer of any copyright in the

computer software by the assessee to its customers, we observe that all the arguments put forth by the AO and the assessee are considered and answered by the Jurisdictional High Court in these decisions. Further, the Delhi High Court in *Infrasoft (supra)* has specifically expressed its disagreement with the view taken by the Hon'ble Karnataka High Court in the case of Samsung Electronics Co Ltd. *(supra)*. Hence, the decisions relied by the AO in the case of Samsung Electronics and GracemacCorpn. *(supra)* does not help the case of the Revenue, as we are under the Jurisdiction of the Hon'ble Delhi High Court.

5.3 Accordingly, respectfully following decision of the Hon'ble jurisdictional High Court in the case of *Infrasoft Ltd. (supra)* and on the basis of discussions above we hold that receipts derived by the assessee from "Sale of Software" is not in nature of "Royalty" as defined under Article 12 of India-Ireland DTAA. Since treaty provisions are more beneficial, an adjudication on nature of receipts *vis a vis* provisions of Section 9(1)(vi) is not required. Grounds Nos. 1 to 4 are accordingly allowed.

5.4 In ground no. 5, the assessee has challenged the levy of interest u/s 234 of the Act. Since the receipt itself is not liable to tax in India interest u/s 234B will be consequential.

5.5 In Ground no. 6, the assessee has challenged the action of initiating levy of penalty. This ground is premature and is dismissed as being premature.

6.0 In the final result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 26th November, 2018.

**Sd/-**

**(ANADEE NATH MISSHRA)  
ACCOUNTANT MEMBER**

**Sd/-**

**(SUDHANSHU SRIVASTAVA)  
JUDICIAL MEMBER**

Dated: 26th NOVEMBER, 2018  
'GS'

Copy forwarded to: -

- 1) Appellant
- 2) Respondent
- 3) CIT(A)
- 4) CIT
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By Order

ASST. REGISTRAR