**IN THE INCOME TAX APPELLATE TRIBUNAL**
**DELHI BENCH: 'A', NEW DELHI**

**BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER**
**AND**
**MS SUCHITRA KAMBLE, JUDICIAL MEMBER**

**ITA No.1288/Del/2015 (A.Y. 2011-12)**
**AND**
**ITA No.4173/Del/2016 (A.Y. 2012-13)**

| Avnet Asia Pte. Ltd.<br>C/o. CA K N Gurunath, CGS & Co., Cas,<br>No. 979, 13 Cross, 19 Main, 11 Floor, BSK II Stage<br>Bangalore | Vs. | DCIT<br>Circle-1(1)(1),<br>International Taxation,<br>Room No. 409,<br>4th Floor, E-2 Block,<br>Pratyaksh Kar Bhavan,<br>Civic Centre<br>New Delhi |
|---|---|---|
| **PAN : AAICA7012R** | | |
| **(Appellant)** | | **(Respondent)** |

| Appellant by | Sh. Tapas Ram Misra, Adv. |
|---|---|
| Respondent by | Shri G.K.Dhall, CIT, DR (Int. Tax) |

| Date of hearing | 11.09.2019 |
|---|---|
| Date of pronouncement | 18.11.2019 |

**ORDER**

**PER SUCHITRA KAMBLE, JM:**

These two appeals are filed by the assessee against the assessment order dated 24.12.2014 and 28.01.2016 passed by DCIT, Circle-1(1)(1), International Taxation, New Delhi for assessment year 2011-12 and 2012-13 respectively.

2. The grounds of appeal are as under:

**ITA No. 1288/Del/2015 (A.Y. 2011-12)**

1. *"That on the facts and in the circumstances of the case, the impugned assessment order passed pursuant to direction of DRP*

*under section 144C(5) of the Income Tax Act, 1961 ("the Act") is based on incorrect legal and factual premise, contrary to judgments of the jurisdictional High Court, and untenable in law.*

2. *That on the facts and in the circumstances of the case, the Assessing Officer erred on facts and in law in concluding, following direction of the DRP, that the receipt of Rs. 2,91,02,372/- towards supply of software was taxable as "Royalty".*

2.1 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in not appreciating that the appellant was a distributor of software products developed by other companies, and it merely purchased and re-sold the off the shelf software without acquiring or transferring any right to use the copyright in the software.*

2.2 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in not appreciating that the appellant, a distributor, never acquired any copyright in the software, and hence it could not be possibly have transferred any copy-right.*

2.3 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in ignoring the decisions of the jurisdictional Delhi High Court and in following the decisions of the Karnataka High Court instead.*

2.4 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in concluding that the consideration paid by the customers in India for the use of the software would be taxable as royalty, even while recognizing that the appellant never owned any copyrights in the software that it could transfer to the customers.*

*3. That on the facts and in the circumstances of the case, the Assessing Officer erred on facts and in law in concluding, following the direction of DRP, that Rs.3,04,35,127/- received from sale of service package to be taxable as Fees for Technical Services.*

*3.1 That on the facts and in the circumstances of the case, the DRP erred on facts and in law in not appreciating that the appellant was selling warranties, upgrades and similar service packages on behalf of manufacturers of the software without providing any actual service.*

*3.2 That on the facts and in the circumstances of the case, the DRP erred on facts and in law in holding that the appellant was providing technical service while in fact the appellant was not providing any service at all.*

*3.3 That on the facts and in the circumstances of the case, the DRP erred on facts and in law in assuring, without any factual basis, that the appellant 'made available' technical knowledge etc., merely because the customer benefitted from remote support and upgrades provided directly by the manufacturer of software.*

*4 That on the facts and circumstances of the case, the Assessing Officer erred on facts and in law in not allowing credit for tax deducted at source.*

*The appellant craves leave to add to, alter, amend or vary from the aforesaid grounds of appeal at or before the time of hearing."*

**ITA No. 4173/Del/2016 (A.Y. 2012-13)**

1. *"That on the facts and in the circumstances of the case, the impugned assessment order passed pursuant to direction of DRP under section 144C(5) of the Income Tax Act, 1961 ("the Act") is based on incorrect legal and factual premise, contrary to judgments of the jurisdictional High Court, and untenable in law.*

2. *That on the facts and in the circumstances of the case, the Assessing Officer erred on facts and in law in concluding, following direction of the DRP, that the receipt of Rs. Rs. 23,68,26,107/- towards supply of software was taxable as "Royalty".*

2.1 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in not appreciating that the appellant was a distributor of software products developed by other companies, and it merely purchased and re-sold the off the shelf software without acquiring or transferring any right to use the copyright in the software.*

2.2 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in concluding that the consideration paid by the customers in India for the use of the software would be*

*taxable as royalty, even while recognizing that the appellant never owned any copyrights in the software that it could transfer to the customers.*

2.3 *That the Honorable DRP failed to appreciate that payment for a mere resale of computer software de hors any copyright associated with it is not covered within the ambit of clause (v) of the definition of royalty under the Act, ignoring the well settled principles as laid down by the Jurisdiction Hon'ble High Court of New Delhi.*

2.4 *That on the facts and in the circumstances of the case, the DRP erred on facts and in law in ignoring the decisions of the jurisdictional Delhi High Court and in following the decisions of the Karnataka High Court instead.*

*2.5 That the Learned AO as well as the Honorable DRP failed to appreciate that in order to qualify as a royalty payment within the Act, it is to be established that the acquirer, by making payment, obtains all or any of the copyrights of the literary work, being software. Further, distinction has to be made between the acquisition of a 'copyright right' and a 'copyrighted article'*

*2.6 The learned AO and Honorable DRP have erred in determining the above said Income by placing excessive reliance on the retrospective amendment to section 9(l)(vi) by the Finance Act, 2012 read with explanation 4 to the said section by the Finance Act, 2012 holding the Income earned by the assesse as Royalty Income - not appreciating the fact that no retrospective amendment into a domestic law can be read into a Tax Treaty, as judicially decided.*

*2.7 That on the facts and circumstances of the case, the Assessing Officer erred on facts and in law in not allowing credit for tax deducted at source.*

*The appellant craves leave to add to, alter, amend or vary from the aforesaid grounds of appeal at or before the time of hearing."*

3. We are taking up factual aspect of Assessment Year 2011-12 as a lead matter. Avnet Asia Pvt. Ltd. is a 100% subsidiary of Avnet Inc., USA. The

group is B2B distributor of semiconductors, interconnect, passive and electromechanical components, enterprise network and computer equipment, and embedded subsystems from leading manufactures. The assessee company procures goods from vendors in Singapore and other overseas countries for sale to its customers in India. The assessee supplied hardware and software for use by its customers in India. The assessee company filed e-return for Assessment Year 2011-12 declaring NIL income on 30.03.2013. The Notice u/s 143(2) of the Income Tax Act, 1961 was issued on 12.08.2013 to the assessee. In response to various notices the Chartered Account appeared as the Authorised Representative of the assessee attended the case time to time and filed necessary details/ documents. During the course of assessment proceedings, assessee was asked to furnish details of all the revenue streams received/accrued in India. In response assessee furnished details of its total sales vide submission dated 13.02.2014, which is incorporated in the assessment order. The Assessing Officer observed that the assessee is supplying software, hardware and providing services to its clients in India. The assessee was again asked to show cause as to why software licensing shall not be taxed as Royalty income and services provided by the assessee shall not be taxed as FTS. In response the assessee filed detailed legal submissions dated 19.03.2014. The draft assessment order was passed and was served to the assessee on 04.04.2014. Thereafter, the assessee filed objections before the Dispute Resolution Panel (DRP). The DRP vide directions dated 14.11.2014 disposed off the objections of the assessee. The Assessment Order passed on 24.12.2014. The Assessing Officer observed that assessee could not transfer right to the customer without owning it. Therefore, at the time of sale to the customers in India, assessee remains the owner of such rights which are transferred to the customers by the assessee. Therefore, assessee could not merely be categorized as a commission agent or a pass through entity. While providing the software to the customers, assessee company in effect transferred the license to use the software by the customers. The customer was granted a license by the assessee under which

the customer was granted some of the rights by the assessee using which the customer is authorized to copy the code into the hard disk of computer/ equipment, run the executable file/ installer programme, install the programme into the computer/ equipment and run the programme to get the intended result. For this right to use the software a separate consideration is provided under the contract/ Purchase Order. The assessee was also required to render the services of technical support for the equipment. For these services, which requires specialized skills, assessee was separately remunerated. The invoices raised by the assessee also clearly distinguish the nature and quantum and classify the receipts into three distinct heads – (i) supply of hardware, (ii) Licensing of Software and (iii) Technical support services. The Assessing Officer further observed that the assessee took a stand that entire receipts under the contract constitute business income and in absence of PE of assessee in India, these profits cannot be taxed in India. The Assessing Officer discussed each of these category of receipts separately as they are governed by totally different set of rules of International taxation. The first category is the receipts, out of hardware supply under the contracts. This clearly gives rise to business income. In absence of any facts on records to the contrary, the assessee's contention of no PE in India was accepted by the Assessing Officer. The second category is the receipts out of licensing of software under the contract. The Assessing Officer observed that the software has been separately licensed and charged to the customer. Customer also enters into the End User License Agreement with the assessee under the terms and this agreement at the time of the supply, the assessee owns the IPR in this software and the customer is granted some of these rights specially the right to use the software in lieu of an agreed consideration. The Assessing Officer made following additions and assessed total taxable income at Rs. 5,95,37,499/- :-

*Receipt for supply of software* *INR 29,102,372*

*(Held to be Royalty Income taxable @ 10%)*

*Receipt for technical services*

| | |
|---|---|
| *(2,81,91,571 + 22,43,556)* | *INR 3,04,35,127* |
| *(Held to be FTS income taxable @ 10%)* | |
| *Total Taxable Income* | *INR 5,95,37,499* |
| *Taxable @ 10%* | *INR 59,53,750"* |

4. Being aggrieved by the assessment order, the assessee filed appeal before us.

5. As regards Ground No. 1 the same is general in nature. Hence, the same is dismissed.

6. As regards Ground No. 2 to 2.4, the Ld. AR submitted that the assessee was a distributor of software products developed by the other companies, and it merely purchased and re-sold the off the shelf software without acquiring or transferring any right to use the copyright in the software. Thus, it could not be possibly have transferred any copyright. In fact DRP observed that the assessee never owned any copyrights in the software that it could be transfer to the customer. The Ld. AR submitted that the same is covered by the decision of the Tribunal in case of Black Duck Software Inc. vs. DCIT (2017) 86 taxmann.com 62 (Delhi-Trib.). The Ld. AR also relied upon the decision of Hon'ble Delhi High Court in case of CIT vs. DYNAMIC VERTICAL SOFTWARE INDIA P. LTD. [2011] 332 ITR 222 (Delhi) as well as the decision in the case of PCIT vs. M. Tech India (P) Ltd. 381381 ITR 31 (Delhi). The Ld. AR further submitted that the assessee is a trader and not a developer or manufacturer. Avnet Asia and its parent company are all distributors of software and hardware products of various manufacturers. This major fact was ignored by the Assessing Officer as well as DRP. The assessee and its group companies merely buy and sell software products developed by other companies and never acquire any right in the said products. The Ld. AR submitted that this transaction of purchase and sale of third party software products is identical to the facts in the case of Dynamic Vertical Software India (P.) Ltd. ITA No. 1692/2010 decided by the

Hon'ble Delhi High Court. Thus, merely purchasing a software from the third party and selling it to the Indian Customer does not amounts to royalty. The Ld. AR further submitted that the decisions of the Hon'ble Karnataka High Court in case of Samsung Electronics and Synopsis International are distinguished by the assessee but the same was not considered by the AO/DRP.

7. The Ld. DR submitted that the services were provided on the basis of royalty and the same was clearly set out by the Assessing Officer as well as the DRP. The Ld. DR submitted that under Income Tax Act, 1961 taxation of Royalty income arising from software is covered by the provisions of Section 9, Section 115A and Part II of Schedule I of the respective Finance Act. As per Explanation 2 to Section 9(1)(vi) of the Income Tax Act, the term 'royalty is defined as consideration for transfer of all or any right (including the granting of a licence) in respect of a patent, technology or of copyright, trade mark; use of technology; use of a patent, trademark, industrial, commercial or scientific equipment; imparting of information concerning, for the working of, or use of, technology; or concerning technical, industrial, commercial or scientific knowledge; rendering services in connection with the activities in connection with the above, i.e. the activities of the 'use' or 'right to use' or 'in respect of' patent, trademark, technology or copyright. The important feature of the provision is that the payment should be a consideration for transfer (including the granting of a licence), in respect of or the use or right to use a patent, trade mark, technology or copyright. The identification of the consideration of payment is, therefore, necessary to determine whether it is royalty. Such consideration should be in respect of transfer of all or any right (including the granting of a licence), the use or the right to use of copyright, patent, trademark, etc. These expressions convey a clear meaning that the absolute transfer of (all the right in the property or right to use property) property is not a requirement to characterize a payment as royalty. A payment for the absolute assignment and ownership of rights is not a payment for the use of something belonging to another. Accordingly,

payments for transfer of any right in respect of a patent, technology or of copyright, trademark or for simpliciter use of patent, trademark, copy right etc. are in nature of royalty under section 9(1) of the Act. Explanation 4 clarifies that the intention of the legislature has always been to include consideration in respect of transfer of all or any right for use or right to use a computer software (including granting of licence) as royalty, irrespective of the medium through which such right is transferred. Thus, legal ownership of such rights, indirect use of such rights and claims related to the location of such rights will not be material in deciding whether such consideration amounts to royalty. The Ld. DR further submitted that as per India-Singapore DTAA, royalty is defined as consideration for the use or the right to use any copyright of a literary, artistic or scientific work falls within the definition of royalty. Thus, the Assessing Officer as well as DRP has rightly made addition in respect of receipt for supply of software as held to be royalty income. Therefore, the appeal of the assessee deserves to be dismissed.

8. We have heard both the parties and perused all the relevant material available on record. From the submissions of the Ld. AR it is observed that Avnet Asia and its parent company are all distributors of software and hardware products of various manufacturers, but whether they provide the services which include the royalty component or not, this major aspect was neither verified by the Assessing Officer as well as DRP. The Assessing Officer and the DRP has not looked into the aspect of the assessee and its group companies whether they merely buy and sell software products developed by other companies or acquire any right in the said products which involves the royalty components. The case laws referred by the Ld. AR though seem to be on the issue but in the present case the facts were not properly verified by the Revenue authorities. Therefore, it will be appropriate to remand back this issue to the file of the Assessing Officer for proper adjudication of this aspect in light of the decisions mentioned by the Ld. AR. Needless to say, the assessee be given opportunity of hearing by following

principles of natural justice. Ground No. 2 to 2.4 are partly allowed for statistical purpose.

9. As regards to Ground No. 3 to 3.3, the Ld. AR further submitted that the assessee was selling warranties, upgrades and similar service packages on behalf of manufacturers of the software without providing any actual service. The Ld. AR submitted that the assessee was not providing technical service at all. There is no service component involved and the same was clearly set out in the agreements. The Ld. AR further submitted that in assessment year 2011-12, the Assessing Officer should have verified the nature of service packages and direct sale of provision of services relating to FTS.

10. The Ld. DR relied upon the Assessment order and the directions of the DRP.

11. We have heard both the parties and perused all the relevant material available on record. From the perusal of the assessment order it can be seen that the Assessing Officer should have verified the nature of service packages and direct sale of provision of services relating to FTS. This fact is not disputed by the Ld. AR that the nature of services are not properly verified by the Assessing Officer. Therefore, it will be appropriate to remand back this issue to the file of the Assessing Officer for proper adjudication. Needless to say, the assessee be given opportunity of hearing by following principles of natural justice. Ground Nos. 3 to 3.3 are partly allowed for statistical purpose.

12. As regards to Ground No. 4, the Ld. AR submitted that the credit for tax deducted at source should have been allowed by the Assessing Officer.

13. The Ld. DR relied upon the Assessment Order.

14. We have heard both the parties and perused all the relevant record. This aspect is not properly verified by the Assessing Officer as regards credit for tax deducted at source. Therefore, it will be appropriate to remand back this issue to the file of the Assessing Officer. Needless to say, the assessee be given proper opportunity of hearing by following principles of natural justice. Ground No. 4 is partly allowed for statistical purpose.

14. Thus, appeal being ITA No. 1288/DEL/2015 for A.Y. 2011-12 is partly allowed for statistical purpose.

15. As regards appeal being ITA No. 4173/DEL/2016 for A.Y. 2012-13 involves only one issue that of supply of software whether amounts to royalty or not which is identical to the Ground No. 2 to 2.4 of the appeal being ITA No. 1288/DEL/2015 for A.Y. 2011-12 which is adjudicated by us in para 8 hereinabove. The same findings will be applicable here as well. Thus, Ground No. 2 to 2.6 are partly allowed for statistical purpose. As regards Ground No. 3, the same is identical to the Ground No. 4 of appeal being ITA No. 1288/DEL/2015 for A.Y. 2011-12, therefore, Ground No. 3 is also partly allowed for statistical purpose. Hence, appeal being ITA No. 4173/DEL/2016 for A.Y. 2012-13 is partly allowed for statistical purpose.

16. In result, both the appeals filed by the assessee are partly allowed for statistical purpose.

**Order is pronounced in the open court on 18th November, 2019.**

***Sd/-*** ***Sd/-***

**(N.K. BILLAIYA)**
**ACCOUNTANT MEMBER**

**(SUCHITRA KAMBLE)**
**JUDICIAL MEMBER**

Dated: 18th November, 2019.
*BR*
Copy forwarded to:
1. Appellant
2. Respondent

3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi