आयकर अपीलीय अधिकरण, दिल्ली न्यायपीठ "डी", नई दिल्ली में

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'D', NEW DELHI

सुश्री सुषमा चावला, उपाध्यक्ष एवं श्री प्रशांत महर्षि, लेखा सदस्य के समक्ष
BEFORE MS. SUSHMA CHOWLA, VP & SHRI PRASHANT MAHARISHI, AM

आयकर अपील सं. / ITA No.9130/Del/2019
निर्धारण वर्ष / Assessment Year 2016-17

Nagravision S.A.
C/o-Ernst & Young LLP,
Golf View, Corporate Tower,
Tower-B, Sector-42,
Gurugram, Haryana-122002.
PAN-AADCN6048B ....**अपीलार्थी**/Appellant

vs

The ACIT(International Taxation),
Circle-2(2)(2), New Delhi. .... **प्रत्यर्थी** / Respondent

अपीलार्थी की ओर से / Appellant by : Sh. Deepak Chopra, Adv.
प्रत्यर्थी की ओर से / Respondent by : Sh. Satpal Gulati, CIT DR

सुनवाई की तारीख / Date of Hearing : 16.03.2020		घोषणा की तारीख / Date of Pronouncement: 06.07.2020

आदेश / ORDER

PER SUSHMA CHOWLA,VP

The present appeal filed by assessee is against order of ACIT, Circle Int. Tax.-2(2)(2), New Delhi dated 23.10.2019 relating to assessment year 2016-17 against the order passed under section 143(3) r.w.s 144C(13) of the Income-tax Act, 1961 (in short 'the Act').

2. The assessee has raised following grounds of appeal:-

1. "That on the facts and circumstances of the case and in law, the impugned order passed by the Learned Assistant Commissioner of Income Tax, Circle 2(2)(2), International Taxation, Delhi (hereinafter referred to as 'the Ld. AO') under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 ('the Act'), pursuant to the directions of the Learned Dispute Resolution Panel -2, Delhi ('the Ld. DRP'), is a vitiated order, having been passed in violation of principles of natural justice and is otherwise arbitrary and is thus bad in law.

2. That on the facts and circumstances of the case and in law, the Ld. AO has erred in passing the impugned order which is based on surmises and conjectures, and is therefore, bad in law and void-ab-initio.

Non-taxability of revenues from sale of hardware equipment

3. That on the facts and circumstances of the case and in law, the Ld. AO has erred in alleging that the revenue earned by the Appellant from sale of hardware equipment is in the nature of 'Royalty' as per provisions of both, section 9(1)(vi) of the Act and Article 12(3) of the India-Switzerland Double Taxation Avoidance Agreement (India-Swiss tax treaty').

4. That on the facts and circumstances of the case and in law, the Ld. AO has erred in disregarding that the revenue earned by the Appellant from sale of hardware equipment represents business income, which is not taxable in India in the absence of any Permanent Establishment ('PE') of the Appellant in India, in accordance with the provisions of the Act as well as Article 5 read with Article 7 of the India-Swiss tax treaty.

Non-taxability of revenues from supply of Conditional Access Systems ('CAS') and Middleware products (i.e., software products)

5. That on the facts and circumstances of the case and in law, the Ld. AO has erred in alleging that the consideration earned by the Appellant from supply of CAS and Middleware products to the Indian customers falls within the ambit of 'royalties' as defined under section 9(1)(vi) of the Act and Article 12(3) of the India-Swiss tax treaty.

6. That on the facts and circumstances of the case and in law, the Ld. AO has erred in disregarding that the revenue earned by the Appellant from supply of CAS and Middleware products represents business income, which is not taxable in India in the absence of any PE of the Appellant in

India, in accordance with the provisions of the Act as well as Article 5 read with Article 7 of the India-Swiss tax treaty.

Addition to income on account of alleged differences between data as per Form 15CA filings and revenue as per Form 26AS

7. That on the facts and circumstances of the case and in law, the Ld. AO has erred in making an addition (amounting to INR 10,61,66,731) to the Appellant's taxable income on account of alleged mismatch/ difference in the amount of remittances (to the Appellant) reflected in the Form ISCAs filed by three (3) Indian resident customers (as per data available and sourced by the Ld. AO) vis-a-vis revenues reported in Form 26AS of the Appellant.

8. Without prejudice, on the facts and circumstances of the case and in law, the Ld. AO has erred in making addition to income amounting to INR 2,81,29,442 which represents income that has been doubly taxed in the hands of the Appellant as per the impugned assessment order for the subject AY.

9. Without prejudice, on the facts and circumstances of the case and in law, the Ld. AO has erred in disregarding the Appellant's submission that the above proposed addition to income comprises income that is in the nature of revenues from supply of hardware, CAS and Middleware products that are even otherwise not taxable in India under the Act and the India-Swiss tax treaty (as per Grounds 4 and 6 above).

Levy of interest and initiation of penalty proceedings

10. That the Ld. AO has erred in levying interest under sections 234A and 234B of the Act.

11. That the Ld. AO has erred in initiating penalty proceedings under section 271 (1)(c) of the Act.

The appellant submits that each of the above grounds are independent and without prejudice to one other.

That the Appellant reserves its right to add, alter, amend, substitute or withdraw any ground of appeal either before or at the time of hearing of this appeal.

The Appellant prays that appropriate relief be granted on the said grounds of appeal and the facts and circumstances of the Appellant's case."

3. The first issue raised by the assessee vide Ground of appeal Nos. 3 & 4 is against the revenue earned by the assessee from sale of hardware equipment in the nature of 'Royalty' as per provisions of both, section 9(1)(vi) of the Act and Article 12(3) of the India-Switzerland Taxation Avoidance Agreement (India-Swiss Tax Treaty). The case of the assessee is that the revenue earned by the assessee from sale of hardware equipment represents business income, which is not taxable in India in the absence of any Permanent Establishment (in short "PE") of the assessee in India, in accordance with the provisions of the Act as well as Article 5 read with Article 7of the India-Swiss Tax Treaty.

4. Further, the assessee has raised Ground of appeal Nos.5 & 6 against the orders of the Assessing Officer in alleging that the consideration earned by the assessee from supply of CAS and Middleware products to the Indian customers falls within the ambit of 'Royalties' as defined under section 9(1)(vi) of the Act and Article 12(3) of the India-Swiss Tax Treaty. The case of the assessee is that the revenue earned by the assessee from supply of CAS and Middleware products represents business income, which is not taxable in India in the absence of any PE of the assessee in India, in accordance with the provisions of the Act as well as Article 5 r.w. Article 7 of the India-Swiss Tax Treaty.

5. Briefly in the facts of the case the assessee company is a foreign company and heaquartered in Cheseauxsur-Lausanne, Switzerland. It

operates as a wholly owned subsidiary of Kudelski SA-a Swiss entity. It supplies conditional Access System (in short "CAS") products, Middleware Products, digital rights management, and integrated on-demand solutions for content providers and digital television (TV) operators over broadcast, broadband, and mobile platforms. The company offers satellite, terrestrial, cable, and IPTV solutions including content security solutions to manage and enhance pay-TV over broadcast and broadband networks; middleware and applications; consumer conditional access modules; and PCTV adapter solutions. It also offers mobile TV solutions, including mobile TV Micro-SD card and OMA BCAST smartcards. In addition, the company offers maintenance and support service, including hotline, support line, software updates, hardware repairs, remote diagnosis, onsite intervention, and health check services; and professional services, including technical training, system audit, operational mentoring, migration and deployment, system integration, consulting, and set-top box validation services. Its technologies are used by pay-television operators in the United States and Internationally.

6. The Assessing Officer considered the taxability of the CAS and Middleware Products in the hands of the assessee. After considering various aspects of CAS and Middleware Products, the Assessing Officer was of the view that the CAS and Middleware software Products supplied by the assessee to its customers were limited, non-exclusive, non-transferable and non sub licensable license for the territory to use the product for the contractual period. Therefore, the Assessing Officer was of the view that these software make

available a ‘process’ to the customers who “use” the process, while carrying out their business. It is, therefore, clear that in addition to software involving a copyright, these specialized software also represent a “process” which can be used in a particular industry specific core activity. After perusing the contract of the assessee with its clients, it was observed by the Assessing Officer that the CAS consists of a set up of hardware and software. The Assessing Officer thus observed that both the hardware and software are integral part of the CAS. A show cause notice dated 13.12.2018 was issued to the assessee citing the reasons why revenue earned from supply of CAS and Middleware Products should not be treated as ‘Royalty’ income and taxed accordingly. The assessee explained its case in detail and pointed out that it was not a case of ‘Royalty’, as the purchaser of software does not become the owner of the copyright in the software. Reliance was placed on several decisions in this regard. It was also explained what is copyright? The assessee stressed relying on the decisions of the Jurisdictional High Court that the transaction of licensing of software has been held to be sale of copyrighted articles instead of consideration for the use of or the right to use any copyright of a literary, artistic or scientific work. The Assessing Officer was of the view that amended provisions of section 9(1)(vi) of the Act held that *“the CAS consists of software and hardware which are designed to be capable of handling CAS related activities. The taxability of hardware equipments is dealt in the Explanation 2(iva) of Section 9(1)(vi) of the Act and is also covered in the definition of royalties as per the DTAA. The taxability of the CAS and middleware software has been dealt in detailing*

preceding paragraphs and which is covered in both the provisions of the Income Tax Act as well as treaty. In view of the above, it is categorically held that the consideration for CAS and middleware products supplied by the assessee is in the nature of royalty income taxable in India." The said observation were made by the Assessing Officer. The DRP has dismissed the objections filed by the assessee on the ground that SLP was pending against the decision of Hon'ble Delhi High Court in the case of Infrasoft Ltd. in ITA No.1034/2009.

7. The Ld.AR for the assessee referred to the terms of License Agreement placed at pages 40 onwards of the Paperbook. Special reference was made to clause 8, 8.1 to 8.7 of the Agreement. The Ld.AR for the assessee pointed out that the issue stands squarely covered by the decision of Hon'ble Delhi High Court in DIT vs Infrasoft Ltd. 264 CTR 329 (Del.) and DIT & Ors. Vs New Skies Satellite BV & Ors. [2016] 382 ITR 0114 (Del.). He also pointed out that reliance placed upon by the authorities below on the decision of Hon'ble Karnataka High Court in DIT vs Samsung Electronics Company Ltd. [2012] 345 ITR 494 (Kar.) is misplaced. It was also brought to our knowledge that the Hon'ble Delhi High Court in DIT vs Infrasoft Ltd. (supra) had referred to the said decision and held that where limited right to use copyrighted material has been transferred, the same does not give rise to any 'Royalty' income. Coming to the sale of hardware, Ld.AR for the assessee pointed out that the same has been treated to be integral part of CAS and assessed as 'Royalty'.

8. The Ld.DR for the Revenue on the hand pointed out that the Hon'ble Delhi High Court in Infrasoft Ltd. (supra) has decided the issue of copyrighted Article and held the same to be not 'Royalty'. However, in case we come to the definition of Royalty, it talks of process also u/s 9(1)(vi) of the Act. He then placed reliance of the observations of the DRP in para 3.2 and 3.3 at page 4 of the order. The Ld. DR for the Revenue stressed that the Hon'ble Delhi High Court (supra) has not gone into the aspect of the end user, which in the present case is technology driven solution, which changes total use fee structure. He was of the view that dimension has to be seen vis-à-vis customers for whom it is developed; its primary objective is CAS. He placed reliance on the order of the DRP in this regard.

9. The Ld.AR for the assessee pointed out that the Assessing Officer had held it to be in the case of Royalty; even for Satellite and for making signals viewable; for mobile technology, we use technology and process, but we do not use any secret formula.

10. We have heard the rival contentions and perused the record. The Ground of appeal Nos. 1 & 2 raised by the assessee are general and do not require any adjudication.

11. The issue raised vide Ground of appeal No.3 to 6 is interlinked and hence, the same are being decided together.

12. The assessee is a non-resident company incorporated as per laws of Switzerland. The issue which is arising before us is whether consideration

received by the assessee from supply of CAS & Middleware software products alongwith limited supply of hardware equipment is to be taxed as Royalty in the hands of the assessee, in view of the amended provisions of section 9(1)(vi) of the Act and/or Article 12(3) of the DTAA between India and Switzerland.

13. The case of the assessee is that it was licensing its software to its customers, does not 'make available' any process to the customers, who in turn use the process while carrying out their business. Further, no exclusive right in the software are transferred to the customers; it is only a copyrighted Article which is being licensed, and no right to use copyright subsisting in such software is transferred. Therefore, the same does not fall within the definition of Royalty as per amended provisions of section 9(1)(vi) of the Act. The assessee also claimed that the consideration receipt cannot be for use of process, since there was no control of the customer over the software system and all rights therein are retained with the assessee. Further, the transaction merely involves supply of the products on a license basis and not the grant of rights (including any rights towards the copyright) in the software/computer programme embedded with the product.

14. The alternate plea raised by the assessee is that without prejudice and in addition to above, the payments for supply of CAS and Middleware products do not fall within the definition of 'Royalty' as per Article 12(3) of the India-Swiss Tax Treaty, where such definition is narrower in ambit as compared to the Act.

15. On the other hand, the case of the authorities below is that the software which is being licensed by the assessee company is specialized customized software that is provided to its customer in the manner and using the methods that best suit their particular requirements. The present software which is being licensed by the assessee embodies the process which is required to control and manage the specific set of activities involved in the business of the customer. The process embodied in the software is part of the core activity of the business being run by the respective customers of the assessee. Therefore, these software make available a "process" to the customers who "use" the process while carrying out their business. It is, therefore, clear that in addition to software involving a copyright, these specialized software also represent a "process" which can be used in a particular industry specific core activity.

16. The DRP vide paras 3.4 & 3.5 observed as under:-

> *3.4. "It is further discussed by the AO that the software programs basically act as a secret process which processes the input commands of the user to desired output by making use of the hardware. The payment made for right to use of such secret process would definitely take form of 'royalty' as the definition of Royalty in DTAA as well as the Income Tax Act encompasses the right to use of a secret process. In view the same, AO considered the receipts of the assessee are taxable as Royalty u/s 9(1)(vi) of the Act.*
>
> *3.5. From the contract it was observed by the AO that the Conditional Access System consists of a set up of hardware and software and they are integral part of the Conditional Access System. On his query to assessee that why revenue earned from supply of CAS and middleware products should not be treated as royalty income and taxed accordingly, the assessee primarily cited the decision of Director of Income Tax vs Infrasoft Limited (264 ITR 329). Assessee has also quoted the OECD Model, Commentary on Software royalty and ''Copyright' under the Indian Copyright Act, 1957 in his submission."*

17. The DRP concluded by holding as under:-

> *3.9. "Royalty definition in Indian Income Tax Act, 1961 was amended in section to include such transactions also. The AO validly treated it as 'Royalty' in view of the' amended definition of Royalty per section 9 (1) vi read with explanations (explanation 2 in particular) The assesse has challenged this contention by referring to the definition of Royalty in the relevant DTAA. The assesse has also submitted the judgment by Hon'ble Delhi High Court in Director of Income Tax vs. Infrasoft Limited (264 CTR 329) on similar issues where relief has been granted to the assesse basis the definition of Royalty in the DTAA. It has been reported that the department is in appeal before Hon'ble Supreme Court (CC No 19034/2014) against the above referred judgment of Hon'ble Delhi High Court. It has to be borne in mind that the panel is an extension of the assessment process and the AO is now bound by the directions of DRP. Accordingly, the matter needs to be kept alive in view of its pendency before the Apex Court."*

18. The Assessing Officer held the aforesaid consideration received by the assessee on sale of software and hardware as taxable in the hands of the assessee.

19. The question which arises is whether such license of software by the assessee is covered under the term "Royalty" as provided in section 9(1)(vi) of the Act and/or Article 12 of the DTAA. Article 12 of the DTAA between India and Sweden stipulates and defines what is Royalty and fees for technical services. The term 'Royalty' as per clause 3 of Article 12 means payment of any kind received as consideration for the use of or the right to use, any copyright of a literary, artistic, or scientific work, including gains derived from the alienation of any such right or property which are contingent on the productivity, use of deposition thereof. The term 'Royalty' has been defined by clause 3 of Article 12 as payment received for the use of, or the right to use any

copyright. Section 9(1)(vi) of the Act defines 'Royalty'. The authorities below were of the view that because of insertion of Explanation 5 to section 9(1)(vi) of the Act with retrospective effect from 01.06.1976, where the meaning of term 'Royalty' has been extended to include use of copyright or copyrighted article is to be applied and on such application, the assessee was held to be taxable. The case of the assessee is that it had not transferred any copyright but had only parted with copyrighted article, in the form of software, then it is not Royalty and was not covered under the provisions of section 9(1)(vi) of the Act. In the alternate, it is submitted by the learned Authorized Representative for the assessee that since the definition of 'Royalty' has not been amended in Tax Treaty and the said provisions being beneficial, then provisions of Article 12(3) of DTAA with Sweden would apply and the assessee's case would fall within non amended provisions of definition of 'Royalty' under Article 12(3) of DTAA.

20. The Hon'ble High Court of Delhi in DIT Vs. Infrasoft Ltd. (supra) have noted that under the license agreement, license was non-exclusive, non-transferrable and the software had to be used in accordance with agreement; the licensee was permitted to make only one copy of software and associated support information and that also for backup purpose. All copies of software were the exclusive property of 'Infrasoft' and it was stipulated that copy shall include 'Infrasoft' copyright and all copies of software also; and without consent of the licensor, the software could not be loaned, rented, sold, sub-licensed or transferred to any third party. The Hon'ble High Court further went on to hold

that distinction had to be made between acquisition of copyright and copyrighted article; copyrighting was distinct from material object.

21. The Hon'ble High Court in DIT Vs. Infrasoft Ltd. (supra) vide its decision dated 22.11.2013 was of the view that where the assessee was governed by Indo-US DTAA, the income of assessee would be chargeable to tax in terms of provisions of Indo-US DTAA and if the same was more advantageous or beneficial, then definition of the word 'Royalty' as defined in Explanation 2 to section 9(1)(vi) of the Act could not be applied. The Hon'ble High Court vide paras 64 and 65 held as under:-

> *"64. To be taxable as royalty income covered by Article 12 of the DTAA the income of the Assessee should have been generated by the "use of or the right to use of" any copyright.*
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> *65. The issue whether consideration for software was royalty came up for consideration before the Special Bench of the Tribunal in Delhi in the case of MOTOROLA INC VS DEPUTY CIT (2005) 147 TAXMAN 39 (DELHI)**.** The Tribunal has held as under:*
>
>> *155. It appears to us from a close examination of the manner in which the case has proceeded before the Income-tax authorities and the arguments addressed before us that the crux of the issue is 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. This issue really is the key to the entire controversy and we may now proceed to address this issue.*
>>
>> *156. We must look into the meaning of the word "copyright" as given in the Copyright Act, 1957. Section 14 of this Act defines "Copyright" as "the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely:*

It is clear from the above definition that a computer programme mentioned in Clause (b) of the section has all the rights mentioned in Clause (a) and in addition also the right to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme. This additional right was substituted w.e.f. 15.1.2000. The difference between the earlier provision and the present one is not of any relevance. What is to be noted is that the right mentioned in Sub -clause (ii) of Clause (b) of Section 14 is available only to the owner of the computer programme. It follows that if any of the cellular operators does not have any of the rights mentioned in Clauses (a) and (b) of Section 14, it would mean that it does not have any right in a copyright. In that case, the payment made by the cellular operator cannot be characterized as royalty either under the Income-tax Act or under the DTAA. The question, therefore, to be answered is whether any of the operators can exercise any of the rights mentioned in the above provisions with reference to the software supplied by the Assessee.

157. We may first look at the supply contract itself to find out what JTM, one of the cellular operators, can rightfully do with reference to the software. We may remind ourselves that JTM is taken as a representative of all the cellular operators and that it was common ground before us that all the contracts with the cellular operators are substantially the same. Clause 20.1 of the Agreement, under the title "License", says that JTM is granted a non - exclusive restricted license to use the software and documentation but only for its own operation and maintenance of the system and not otherwise. This clause appears to militate against the position, if it were a copyright, that the holder of the copyright can do anything with respect to the same in the public domain. What JTM is permitted to do is only to use the software for the purpose of its own operation and maintenance of the system. There is a clear bar on the software being used by JTM in the public domain or for the purpose of commercial exploitation.

158. Secondly, under the definition of "copyright" in Section 14 of the Copyright Act, the emphasis is that it is an exclusive right granted to the holder thereof. This condition is not satisfied in the case of JTM because the license granted to it by the Assessee is expressly stated in Clause 20.1 as a "non exclusive restricted license". This means that the supplier of the software, namely, the Assessee, can supply similar software to any number of cellular operators to which JTM can have no objection and further all the cellular operators can use the software only for the purpose of their own operation and maintenance of the system and not for any other purpose. The user

of the software by the cellular operators in the public domain is totally prohibited, which is evident from the use of the words in Article 20.1 of the agreement, "restricted" and "not otherwise". Thus JTM has a very limited right so far as the use of software is concerned. It needs no repetition to clarify that JTM has not been given any of the seven rights mentioned in Clause (a) of Section 14 or the additional right mentioned in Sub-clause (ii) of Clause (b) of the section which relates to a computer programme and, therefore, what JTM or any other cellular operator has acquired under the agreement is not a copyright but is only a copyrighted article.

159. Clause 20.4 of the supply contract with JTM is as under:

> *20.4 In pursuance of the foregoing JT MOBI LES shall:*
>
> *(a) not provide or make the Software or Documentation or any portions or aspects thereof (including any methods or concepts utilized or expressed therein) available to any person except to its employees on a "need to know" basis;*
> *(b) not make any copies of Software or Documentation or parts thereof, except for archival backup purposes;*
> *(c) when making permitted copies as aforesaid transfer to the copy/copies any copyright or other marking on the Software or Documentation.*
> *(d) Not use the Software or Documentation for any other purpose than permitted in this Article 20, Licence or sell or in any manner alienate or part with its possession.*
> *(e) Not use or transfer the Software and/or the Documentation outside India without the written consent of the Contractor and after having received necessary export or re -export permits from relevant authorities.*
>
> *This clause places stringent restrictions on the cellular operator so far as the use of software is concerned. It first says that the cellular operator cannot make the software or portions thereof available to any person except to its employees and even with regard to employees it has to be only on a "need to know basis" which means that even the employees are not to be told in all its aspects. What the Assessee can do is only to tell the particular employee what he has to know about the software for operational purposes. The cellular operator has been denied the right to make copies of the software or parts thereof except for archival backup purposes. This means that the cellular operator cannot make copies of the software for commercial purposes. This condition is plainly contrary to Section 14(a)(i) of the Copyright Act*

> *which permits the copyright holder to reproduce the work in any material form including the storing of it in any medium by electronic means. We may also notice Section 52(1)(aa) of the Copyright Act which lists out certain acts which cannot be considered as infringement of copyright. The particular clause permits the making of copies or adaptation of a computer programme by the lawful possessor of the copy and the computer programme in order to utilize the public programme for the purpose for which it was supplied or to make backup copies purely as a temporary protection against loss, destruction or damage. Therefore, merely because the cellular operator has been permitted to take copies just for backup purposes, it cannot be said that it has acquired a copyright in the software.*

160. Clause 20.4(c) makes it mandatory for the cellular operator, while making copies of the software for backup purposes, to also mark the copied software with copyright or other marking to show that the rights of the Assessee are reserved. This is one more indication that what the cellular operator acquired is not a copyright.

161. Clause 20.4(d) says that the cellular operator cannot use the software for any other purpose than what is permitted and shall not also license or sell or in any manner alienate or part with its possession. This has to be read with Clause 20.5 which says that the license can be transferred, but only when the GSM system itself is sold by the cellular operator to a third party. This in a way shows that the software is actually part of the hardware and it has no use or value independent of it. This restriction placed on the cellular operator (not to license or sell the software) runs counter to Section 14(b)(ii) of the Copyright Act which permits a copyright holder to sell or let out on commercial rental the computer programme. For this reason also it cannot be said that JTM or any cellular operator acquired a copyright in the software.

162. A conjoint reading of the terms of the supply contract and the provisions of the Copyright Act, 1957 clearly shows that the cellular operator cannot exploit the computer software commercially which is the very essence of a copyright. In other words a holder of a copyright is permitted to exploit the copyright commercially and if he is not permitted to do so then what he has acquired cannot be considered as a copyright. In that case, it can only be said that he has acquired a copyrighted article. A small example may clarify the position. The purchaser of a book on income-tax acquires only a copyrighted article. On the other hand, a recording company which has recorded a vocalist has acquired the copyright in the music

rendered and is, therefore, permitted to exploit the recording commercially. In this case the music recording company has not merely acquired a copyrighted article in the form of a recording, but has actually acquired a copyright to reproduce the music and exploit the same commercially. In the present case what JTM or any other cellular operator has acquired under the supply contract is only the copyrighted software, which is an article by itself and not any copyright therein.

163. We may now briefly deal with the objections of Mr. G.C. Sharma, the learned senior counsel for the Department. He contended that if a person owns a copyrighted article then he automatically has a right over the copyright also. With respect, this objection does not appear to us to be correct. Mr. Dastur filed an extract from Iyengar's Copyright Act (3rd Edition) edited by R.G. Chaturvedi. The following observations of the author are on the point:

> *"(h) Copyright is distinct from the material object, copyrighted:*
>
> *It is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. The copyright owner may dispose of it on such terms as he may see fit. He has an individual right of exclusive enjoyment. The transfer of the manuscript does not, of itself, serve to transfer the copyright therein. The transfer of the ownership of a physical thing in which copyright exists gives to the purchaser the right to do with it (the physical thing) whatever he pleases, except the right to make copies and issue them to the public" (underline is ours).*

The above observations of the author show that one cannot have the copyright right without the copyrighted article but at the same time just because one has the copyrighted article, it does not follow that one has also the copyright in it. Mr. Sharma's objection cannot be accepted.

164. It is not necessary, therefore, to consider the alternative argument of Mr. Dastur, namely, that even assuming that the Department is right in saying that if you have the copyrighted article, you also have the copyright right therein, still it would mean that the copyright rights are transferred (acquired by JTM) and it would not be a case of merely giving the right to use and consequently Article 13 of the DTAA would not apply. Mr. Dastur, however, was fair enough to concede that if the Department is right

in saying that if you have the copyrighted article, you also have the copyrighted rights, then Clause (v) of Explanation 2 below Section 9(1) of the Income-tax Act will apply because his clause ropes in "transfer of all or any rights" and is not restricted to "use" or "right to use", the copyright. However, he added that since the basic proposition of the Department has been demonstrated to be wrong, Clause (v) of Explanation 2 below Section 9(1) is not an impediment to accepting the assessee's contention.

165. We may also usefully refer to the Commentary on the OECD Model Convention (dated 28.1.2003) which is of persuasive value and which throws considerable light on the character of the transaction and the treatment to be given to the payments for tax purposes. Paragraph 14 of the Commentary, a copy of which was filed in Paper book No. V is relevant:

COMMENTARY ON ARTICLE 12 - PAPER BOOK V

> *"14. In other types of transactions, the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program, for example, where the transferee is granted limited rights to reproduce the program. This would be the common situation in transactions for the acquisition of a program copy. The rights transferred in these cases are specific to the nature of computer programs. They allow the user to copy the program, for example onto the user's computer hard drive or for archival purposes. In this context, it is important to note that the protection afforded in relation to computer programs under copyright law may differ from country to country. In some countries the act of copying the program onto the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of many countries automatically grant this right to the owner of software which incorporates a computer program. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, 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 commercial income in accordance with Article 7."*

166. We may also usefully refer to the proposed amendments to the regulations of the Internal Revenue Service (IRS) in the USA.

Again these regulations may not be binding on us but they have a persuasive value and throw light on the question before us, namely the difference between a copyright right an d a copyrighted article. These regulations have been placed at pages 136 to 157 of Paper book No. II. The actual regulations as well as the explanatory Note explaining the object and the purpose of the proposed regulations have also been given. In paragraph 1 of the Note titled "Background", it has been stated that the proposed regulations require that a transaction involving a computer programme may be treated as being one of the four possible categories. Two such categories are the transfer of copyright rights and the transfer of a copyrighted article. The U.S. regulations distinguished between transfer of copyright rights and transfer of copyrighted articles based on the type of rights transferred to the transferee. Briefly stated, if the transferee acquires a copy of a computer programme but does not acquire any of the rights identified in certain sections (of the U.S. Regulations), the regulation classified the transaction as the Transfer of a copyrighted article. Paragraph 3 of the Explanatory Note says that if a transfer of a computer programme results in the transferee acquiring any one or more of the listed rights, it is a transfer of a copyright right.

167. Paragraph 4 says that if a person acquires a copy of a computer programme but does not acquire any of the four listed copyright rights, he gets only a copyrighted article but no copyright.

168. The actual regulations bring out the distinction very clearly between the copyright right and a copyrighted article. They also specify the four rights which, if acquired by the transferee, constitute him the owner of a copyright right. They are:

> *(a) The right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending.*
>
> *(ii) The right to prepare derivative computer programmes based upon the copyrighted computer programme*
> *(iii) The right to make a public performance of the computer programme.*
> *(iv) The right to publically display the computer programme.*

169. A copyrighted article has been defined in the regulation (page 147 of the paper book) as including a copy of a computer programme

from which the work can be perceived, reproduced or otherwise communicated either directly or with the aid of a machine or device. The copy of the programme may be fixed in the magnetic medium of a floppy disc or in the main memory or hard drive of a computer or in any other medium.

170. So far as the transfer of copyrighted articles and copyright rights are concerned, the regulation goes on to say (page 148 of the paper book) that the question whether there was a transfer of a copyright right or only of a copyrighted article must be determined taking into account all the facts and circumstances of the case and the benefits and burden of ownership which have been transferred. Several examples have been given below these regulations to find out whether a particular transfer is a transfer of a copyright right or a transfer of a copyrighted article.

171. The Commentary of "Charl P. du TOIT" on this question has been placed at pages 202 to 204 of Paper book No. II. The Commentary is titled "Beneficial ownership of royalties in Bilateral Tax Treaties." He has opined that articles such as Books and Records are copyrighted articles and if they are sold, the user does not obtain the right to use any significant rights in the underlying copyright itself, which is what should determine the characterization of the revenue as sale proceeds rather than royalties. He has further opined that consideration relating to sale of software can amount to royalty only in limited circumstances.

172. For the above reasons, we are of the view that the payment by the cellular operator is not for any copyright in the software but is only for the software as such as a copy righted article. It follows that the payment cannot be considered as royalty within the meaning of Explanation 2 below Section 9(1) of the Income-tax Act or Article of the DTAA with Sweden.

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184. In view of the foregoing discussion, we hold that the software supplied was a copyrighted article and not a copyright right, and the payment received by the Assessee in respect of the software cannot be considered as royalty either under the Income-tax Act or the DTAA."

22. The Hon'ble High Court of Delhi in DIT Vs. Infrasoft Ltd. (supra) then refers to the decision of the Hon'ble High Court of Delhi itself in DIT Vs.

Ericsson A.B. (2012) 343 ITR 470 (Del), wherein it was held that once it is held that payment in question is not Royalty which would come within the mischief of clause (vi), the Explanation will have no application and that the question of applicability of the Explanation would arise only when payment is to be treated as "Royalty" within the meaning of clause (vi) or "fee for technical services" as provided in clause (vii) of the Act. After referring to different terms of Licensing Software Agreement, the Hon'ble High Court observed as under:-

> *"85. The Licensing Agreement shows that the license is non-exclusive, non-transferable 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 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 Infrasoft 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 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."*

23. The Hon'ble High Court concluded by holding as under:-

> *"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.

90. The license granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use is only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process is necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said paragraph because it is only integral to the use of copyrighted product. Apart from such incidental facility, the licensee has no right to deal with the product just as the owner would be in a position to do.

91. There is no transfer of any right in respect of copyright by the Assessee and it is a case of mere transfer of a copyrighted article. The payment is for a copyrighted article and represents the purchase price of an article and cannot be considered as royalty either under the Income Tax Act or under the DTAA."

24. The Hon'ble High Court then referred to the decision of the Hon'ble High Court of Karnataka in CIT Vs. Samsung Electronics Co. Ltd. (supra) and distinguished the same holding as under:-

"*98. We are not in agreement with the decision of the Andhra Pradesh High Court in the case of Samsung Electronics Co. Ltd (supra) that right to make a copy of the software and storing the same in the hard disk of the designated computer and taking backup copy would amount to copyright work under section 14(1) of the Copyright Act and the payment made for the grant of the licence for the said purpose would constitute royalty. The license granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use was only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process was necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product. The right to make a backup copy purely as a temporary protection against loss, destruction or damage has been held by the Delhi High Court in DIT v. M/s Nokia Networks OY (Supra) as not amounting to acquiring a copyright in the software."*

25. Further, the Hon'ble High Court of Delhi in Pr.CIT vs M.Tech India Ltd. (P.) [2017] 381 ITR 31 (Del.) held as under:-

> *"12. In the cases where an Assessee acquires the right to use a software, the payment so made would amount to royalty. However in cases where the payments are made for purchase of software as a product, the consideration paid cannot be considered to be for use or the right to use the software. It is well settled that where software is sold as a product it would amount to sale of goods. In the case of Tata Consultancy Services v. State of Andhra Pradesh: (2004) 271 ITR 401 (SC), the Supreme Court examined the transactions relating to the purchase and sale of software recorded on a CD in the context of the Andhra Pradesh General Sales Tax Act. The court held the same to be goods within the meaning of Section 2(b) of the said Act and consequently exigible to sales tax under the said Act. Clearly, the consideration paid for purchase of goods cannot be considered as 'royalty'. Thus, it is necessary to make a distinction between the cases where consideration is paid to acquire the right to use a patent or a copyright and cases where payment is made to acquire patented or a copyrighted product/material. In cases where payments are made to acquire products which are patented or copyrighted, the consideration paid would have to be treated as a payment for purchase of the product rather than consideration for use of the patent or copyright."*

26. The Hon'ble High Court has thus, made distinction between the cases where consideration is paid to acquire right to use, patent or copyright and cases where payment is made to acquire patented or copyrighted products / material and has held that where the payment is made to acquire products which are patented or copyrighted, consideration paid would have to be treated as payment for purchase of product rather than consideration for use of patent or copyright. In para 13, the Hon'ble High Court in Pr.CIT Vs. M.Tech India (P) Ltd. (supra) refers to earlier decision of Coordinate Bench of the Hon'ble High Court of Delhi in DIT Vs. Infrasoft Ltd. (supra) and also refers to the reliance

placed upon by the Revenue on the decision of the Hon'ble High Court of Karnataka in CIT Vs. Samsung Electronics Co. Ltd. (supra) and holds that the Bench in DIT Vs. Infrasoft Ltd. (supra) has unequivocally expressed its view that it was not in agreement with that decision. The question was thus, decided holding the consideration paid could not be considered as 'royalty' for use or right to use software.

27. Further, reference may also be made to earlier decision of the Hon'ble High Court of Delhi in DIT Vs. Ericsson A.B. (supra). Relying on the ratio laid down by the Hon'ble Supreme Court in Tata Consultancy Services Vs. State of Andhra Pradesh (2004) 271 ITR 401 (SC), the Hon'ble High Court of Delhi in DIT Vs. Ericsson A.B. (supra) had held as under:-

> "*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.*
>
> ....
>
> *59. Be that as it may, in order to qualify as royalty payment, within the meaning of section 9(1)(vi) and particularly clause (v) of Explanation 2 thereto, 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. 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 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.

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."

28. The Hon'ble High Court of Delhi in DIT Vs. Infrasoft Ltd. (supra) has taken note of the said decision of DIT Vs. Ericsson A.B. (supra) in para 71 and in para 72 held as under:-

"72. The Delhi High Court further in ERICSSON CASE (SUPRA) further held that once it is held that payment in question is not royalty which would come within the mischief of clause (vi), the Explanation will have no application and that the question of applicability of the Explanation would arise only when payment is to be treated as "royalty" within the meaning of clause (vi) or "fee for technical services" as provided in clause (vii) of the Act."

29. The Hon'ble High Court of Delhi in DIT Vs. Nokia Networks OY (2013) 358 ITR 259 (Del) had held that Explanation 4 was added to section 9(1)(vi) of the Act by Finance Act, 2012 with retrospective effect from 01.06.1976 to

provide that all consideration for use of software shall be assessable as 'Royalty'. However, the definition in DTAA has been left unchanged. It is an admitted fact that though Explanation 5 has been inserted in section 9(1)(vi) of the Act but no amendment has been made to the definition of 'Royalty' under DTAA and since the provisions of DTAA are beneficial to the assessee, then the said provisions would be applied.

30. In view of the above said propositions, we hold that what has been transferred is limited right to use copyrighted material, then the receipts on sale of licensing of software is not Royalty in view of the beneficial provisions of the DTAA between India and Sweden. We further hold that amended definition of 'Royalty' under the domestic law cannot be extended to the definition of 'Royalty' under DTAA, where the term 'Royalty' originally defined has not been amended. As per definition of 'Royalty' under DTAA, it is payment received in consideration for use or right to use any copyright of literary, artistic or scientific work, etc.; thus, purchase of copyrighted article does not fall in realm of 'Royalty'. We also hold that since the provisions of DTAA overrides the provisions of Income Tax Act and are more beneficial and the definition of 'Royalty' having not undergone any amendment in Tax Treaty, the assessee was not liable to be taxed on aforesaid receipts of Licensing software and also on sale of Hardware. Accordingly, we hold so. The Ground of appeal Nos. 3 to 6 are thus allowed.

31. The Ground of appeal Nos. 7 to 9 are alternative and in view of our deciding the issue of taxability of 'Royalty' income, becomes academic; hence, dismissed.

32. The Ground of appeal No.10 of charging interest u/s 234A & 234B of the Act is consequential; hence, dismissed.

33. The Ground of appeal No.11 is premature; hence, dismissed.

34. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 06th July, 2020.

Sd/- **Sd/-**

(PRASHANT MAHARISHI) **(SUSHMA CHOWLA)**
लेखा सदस्य / ACCOUNTANT MEMBER **उपाध्यक्ष / VICE PRESIDENT**

दिल्ली / **दिनांक** Dated : 06th July, 2020
** Amit Kumar **
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2. **प्रत्यर्थी** / The Respondent
3. **आयकर आयुक्त (अपील)**/ The CIT(A)
4. **मुख्य आयकर आयुक्त** / The Pr. CIT
5. **विभागीय प्रतिनिधि,आयकर अपीलीय अधिकरण , दिल्ली** / DR, ITAT, Delhi
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सहायक रजिस्ट्रार, आयकर अपीलीय अधिकरण ,दिल्ली
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