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

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER
AND
SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER

ITA No. 3826/Del/2017
(Assessment Year: 2014-15)

MICRO FOCUS LTD., The Lawn, 22-30, Old Bath Road, Berkshire, RG141QN, United Kingdom.	**Vs.**	**DCIT, Circle 2(2)(1), Intl. Taxation, New Delhi**
PAN No. AAGCM3842B		
Appellant		**Respondent**

Assessee by	Sh. Vishal Kalra, Advocate Ms. Sumisha Sumuragi, CA
Revenue by	Sh. Satpal Gulati, CIT/DR

Date of hearing	02/11/2020
Pronouncement on	04 /11/2020

ORDER

PER K. NARASIMHA CHARRY, JM

Aggrieved by the assessment order dated 07.04.2017 pursuant to directions dated 09.03.2017 of ld. DRP u/s. 144C(5) of the Income Tax Act (for short "the Act"), the assessee preferred this appeal.

2. Brief facts of the case are that the assessee is a company incorporated in United Kingdom and engaged in the business of development and distribution of software products and it sells its software

products in India either through distributors or directly to the customers. According to the assessee, they have no offices/project offices/ godowns or any other business or presence in India and sale of software products is conducted outside India, on principal to principal basis, with Indian purchasers.

3. For the assessment year 2014-15, the assessee filed their return of income on 30.09.2014 declaring nil income. Ld. Assessing Officer, however, by order dated 29.11.2016 proposed to make an addition of Rs.10,80,18,856/- by treating the receipts from sale of software products as royalty income despite the contention of the assessee that it cannot be taxed so because the distributors do not act on behalf of the assessee and the agreements with distributors gives non-exclusive rights to the distributors to market and distribute the software products to third parties throughout the territory in object code form; that the distributor will act as independent contractor only and will neither act on behalf of Micro Focus nor purport to represent Micro Focus in any way; that the agreement does not licence Distributor to use the software products for any purpose whatsoever including without limitation the use of the software products internally or in a service bureau or time-sharing basis; and that distributor has no right to copy, modify, reverse engineer, decompile, disassemble or repackage the software products in any.

4. Aggrieved by such proposal in the draft assessment order, the assessee filed objections before the DRP. Ld. DRP vide order dated 09.03.2017 u/s. 144C(5) confirmed the additions proposed by Assessing Officer by placing reliance on its directions for preceding assessment years in assessee’s own case for assessment years 2009-10 and 2010-11, and

further observing that assessee sold the software in Indian market through a network of dealers and such software is capable of replication and multiplication. Ld. DRP further observed that in order to invoke the beneficial provision of section 90(2) of the Act, the assessee has to first necessarily concede the application of section 9(1)(vi) of the Act. Pursuant to DRP's directions, ld. Assessing Officer passed the final assessment order dated 07.04.2017 u/s. 143(3) r.w.s. 144C(13) of the Act. Ld. Assessing Officer further granted credit to tax deducted at source only to the tune of Rs. 1,17,68,759/- as against the credit of Rs.1,56,59,151/- as provided in Form 26AS.

5. The assessee is, therefore, before us in this appeal, challenging the addition made by ld. Assessing Officer pursuant to DRP's directions and also the grant of partial credit of TDS.

6. Learned AR while drawing our attention to clause Nos. 1.2.3, 1.4.1, 2.2.1, 2.2.2, 2.2.3(v) and 2.2.3(vi) of the distributor agreement, submitted that the Appellant is a tax resident of UK and accordingly, in view of section 90(2) of the Act, the provisions of the Act or the DTAA, whichever is more beneficial to the Appellant shall apply. Since the definition of royalty provided under Article 13 of the India - UK DTAA ("DTAA"), being more beneficial as compared to the provisions of section 9(1)(vi) of the Act, shall apply; that in the instant case, the software supplied by the Appellant to Indian distributors does not fall under any of the categories mentioned in Article 13 of the DTAA, and in particular, it does not fall within the meaning of 'copyright'. The Appellant grants the distributor(s), non-exclusive, non-transferrable and non-assignable rights and they are not imparted with any right to commercially exploit the rights of the

Appellant. The main thrust of the agreement between the Appellant and the Distributor is summarized as under:

- Distributor(s) have non-exclusive right to market and distribute the Software Products to third parties throughout the territory in object code form (refer clause 1.3.2 of the distributor agreement placed at page 13 of the paperbook volume 1).

- Distributor(s) will act as an independent contractor only and will neither act on behalf of Micro Focus nor purport to represent Micro Focus in any way (refer clause 1.4.1 of the distributor agreement placed at page 13 of the paperbook volume 1).

- Distributor(s) have no right to grant sub-license for software products and Appellant will license the software products directly to end users through Appellant's end user license agreement (refer clause 2.2.1 of the distributor agreement placed at page 14 of the paperbook volume 1).

- Distributor(s) will execute a written dealer agreement with dealers as per which:

  • The Appellant's right in software will be protected;

  • There is no reverse engineering, decompiling and dissembling of the object code; and

  • Dealers will not make any representation or warranties on behalf of Appellant. (refer clause 2.2.2 of the distributor agreement placed at page 15 of the paperbook volume 1).

-Distributor(s) can use the trademark of Appellant only for the specific purpose of indicating to the public that they are authorized by the Appellant but they will indicate that the Appellant is sole owner of trademark and on termination will immediately cease all use of Appellant's trademark (refer clause 2.2.3 (v) of the

distributor agreement placed at page 15 of the paper book volume 1).

- All the rights, including all intellectual property rights in the products, updates and other localizations or translations are owned by the Appellant and no ownership rights have been transferred to the Distributor(s) (refer clause 2.2.3 (vi) of the distributor agreement placed at pages 15 and 16 and clause 4.1 of the distributor agreement placed at page 19 of the paper book volume 1).

7. Learned AR, therefore, submits that from the afore-mentioned relevant clauses of the sample distributor agreement entered by the Appellant for sale of software products, it is amply clear that such agreement is entered solely for the sale of software product and do not in any way entail transfer of ownership of any patents, copyrights, or any other intellectual property rights.

8. Basing on this, he submitted that by the sale of software product, what is being transferred is not the right to use the copyright, but only limited right to use the copy righted articles and the sale consideration received by assessee from the customers for the sale of software product ought not to be treated as being a consideration for use of the copyright. Consequently, the receipts from sale of software products are not taxable in India as per Article 13 of DTAA read with the Act.

9. He further submitted that similar question arose in immediately preceding assessment years, i.e., 2008-09 to 2011-12 and 2013-14 in ITA Nos. 2376, 2377, 3312 and 3313/Del/2016 and the Tribunal by order dated 15.05.2018 held that for the sale of software what was transferred is not the right to use the copyright, but only limited right to use the copy

righted article and on that premises, allowed the claim of the assessee.

10. Learned DR submits that the assessee has not filed application for not withholding tax certificates under section 195 or 197 of the Act and, therefore, it amount to acceptance of assessee that its receipts are taxable in India. He further submitted that as per the distributor agreement, the distributor(s) has right to use Micro Focus trademark and trade name where appropriate and per copy license fees is paid by the distributor to the Appellant apart from maintenance fees and upgrade fees. Further, distributors may permit dealers to distribute object code copies of the software products to end user customers.

11. We have gone through the record in the light of submissions made on either side. There is no dispute that a similar question has arisen in assessee's own case for immediately preceding assessment years in respect of treatment of receipts – whether as royalty or the sale consideration for sale of copy righted articles. It is also not in dispute that by order dated 17.05.2018, the coordinate Bench of this Tribunal reached a conclusion that it is a matter of sale and copy righted article and not the transfer of right to use the copyright. For the sake of convenience, we find it necessary to extract the relevant portion of the orders of Tribunal, which are thus ;-

> *"6. We have heard both the parties and perused the material available on record. The Distributer Agreement gives non-exclusive ratio to only distributor to market and distribute the software products to third parties throughout the territory distributor will Act as independent Contractor only and will neither Act on behalf of Micro Focus nor purport to represent Micro Focus in any way. Thus, the Ld. AR submitted that the consideration received by the micro focus from the customers in India towards off shore supply of software could not be charitable to tax in India under the Act read*

with India UK Tax. **The assesse enters into contracts with its customers on principal to principal basis and that the sale of software licenses is made outside of India. No portion of sale is carried out in India and the payment is made directly by the customers to the bank account in United Kingdom.** *It is pertinent to note that the Assessing Officer has referred this distributor agreement but has not taken the cognizance of the Clause of these agreements. The submissions made by the Ld. AR clearly set out what are the effects of this Distribution Agreement. In view of Section 90(2) of the Income Tax Act, the assessee opts for Double Taxation Avoidance Agreement between India and UK to override the provision of the Act as there is no corresponding amendment to the definition of the term royalty in Article 13(3) of the aforesaid DTAA as carried out in the definition of royalty u/s 9 (1)(6) of the Act.* **The amendment will not be applicable as held in Hon'ble Delhi High Court decision in case of Infra Soft Ltd. (supra). The Income represents business income of the respondent***outside of India and should be covered under the definition of royalty. In absence of any permanent established in India, the same would not be chargeable to Tax in India in Article 7 of India UK Tax Treaty. Further, the same cannot be treated as royalty income under the Act or India-UK Tax Treaty.*

*7. The assessee is only selling copy righted article and there is no payment for use of copy right or acquiring the right to use the copy right and hence the same is not covered within the definition of royalty in DTAA. It is the separate position that the payment made for the use of copy righted article should be treated as business income and not the royalty income. The reliance on the Hon'ble Delhi High Court decision in case of Infra Soft Ltd. and M. Tech. India Pvt. Ltd is relevant in the assessee's case as Infra Soft Ltd***. The Hon'ble High Court held in the order that payment to be qualified as a royalty payment it is necessary to establish that there is a transfer of all or any rights including grant of license in respect of copy right of a literally artistic or scientific work. In order to treat the consideration paid by the licensee is royalty, it is to be established that the licensee by making such payments obtains all or any of the copy righted rights of such literally work. The parting of intellectual property rights inherent in and attach to the software product in favoure of the licensee customer is what is contemplated by the treaty for payment to be classified as royalty payment. The enjoyment of some or all the rights which the copy right owner has necessary to invoke the royalty definition view from this angle on non-exclusive and non-transferable license in attempting the use of**

a copy righted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingredient article 12 of DTAA. *The license granted to the licensee permitting him to do the computer program 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 copy righted product for his internal business purpose. The said process is necessary to make the program functional and to have excess to it and is qualitatively different from the right contemplated by the said paragraph because it is only integral to the use of copy righted product apart from such incidental facilities*. *The licensee has no right to deal with the product just as the owner would be in a position to do. The licensee has been prohibited from copying, decompiling, de-assembling or reverse engineering the software without the written consent of Infra Soft.* **The license agreement between Infra Soft and its customers stipulates that all copyrights and intellectual property rights in the software and copies made by the licensee were own by Infrasoft and only Infrasoft has the power to grant license rights for use of the software. The license granted by the Infrasoft 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 archival copy is an essential step in utilizing 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 of India-UK DTAA.*

8. Thus, the issue relating to the consideration received by the assesse from various entities on account of sale of software is not royalty within the meaning of Article 13of the India UK DTAA, the effect of Article 3(2) of DTAA clearly set out the definition of royalty as per the distributor agreement and the end user license agreement which was produced before the Assessing Officer as well as before the CIT(A)"

12. In these circumstances, while respectfully following the finding of the Tribunal covering the issue under grounds Nos. 1 to 4, we hold the issue in favour of the assessee and allow these ground Nos. 1 to 4 accordingly.

13. Now, coming to ground No. 5, it is submitted that assessee filed rectification application on 20.06.2017 before the Assessing Officer claiming refund of Rs.38,90,391/- and the same is pending. Suffice it to say that the Assessing Officer would verify the facts and take the view according to law in this matter.

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

Order pronounced in the open court on 04/11/2020

Sd/-	Sd/-
(N.K. BILLAIYA)	**(K. NARSIMHA CHARRY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Dated: 04/11/2020
aks/-