

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(IT)A No.739/Bang/2020
Assessment year: 2017-18

Quest Software International Ltd., City Gate Park, Mahon, Cork, Ireland. C/o. King & Patridge, Advocates, 48, Lavelle Road, Bangalore – 560 001. PAN: AAACQ 2102L	Vs.	The Deputy Commissioner of Income Tax (International Taxation), Circle 2(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Ms. Mahima Goud, Advocate
Respondent by	:	Ms. Neera Malhotra, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	18.08.2021
Date of Pronouncement	:	23.08.2021

ORDER

Per Chandra Poojari, Accountant Member

This appeal is by the assessee against the order dated 29.10.2020 passed by the Assessing Officer u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 [the Act] on the following grounds :-

“The Appellant submits that:

1. That the order of the Respondent / Assessing Officer (AO' for short) pursuant to the directions of the Dispute Resolution Panel (the DRP' for short), is erroneous, contrary to the facts

and circumstances of the case and is therefore liable to be set aside.

2. Treatment of income from sale of off-the-shelf software as 'royalty'.

- a. The AO and the DRP erred in law and on facts in treating the entire consideration received from Indian customers towards sale of shrink wrapped and off-the shelf software as 'royalty' under Section 9(1)(vi) of the Income-tax Act, 1961 ("the Act") and also under Article 12 of the India-Ireland Double Taxation Avoidance Agreement ("India-Ireland DTAA").
- b. The AO and DRP erred in holding that granting of license to use the software amounts to transfer of rights in the copyright and consequently the provisions of Section 9(1)(vi) of the Act are attracted.
- c. The AO and DRP erred in holding that the income from the sale of shrink wrapped and off the shelf software products accrued or arose in India as per Section 5(2) of the Act, merely because the payers are situated in India.
- d. The AO and DRP erred in holding that there is a transfer of the underlying copyright in the software, between the Appellant and its customers, in spite of the fact that the Appellant has sold shrink wrapped computer software, being a copyrighted article and not the copy right itself.
- e. The AO and DRP have erred in holding that the subject transaction cannot be regarded as sale as there no transfer of all the rights, title and interest in the copyright, without appreciating the fact that no rights were acquired by the Appellant in the first place in relation to the software which was sold onwards to end customers.
- f. The AO and DRP failed to appreciate the difference between 'transfer of a copyright' and 'sale of a copyrighted article'.
- g. The AO and DRP erred in holding that the subject payments would be covered within the provisions of Section 14(b)(ii) of the Copyright Act, 1957, in case of the Appellant, which is

- a foreign company and therefore not governed by the provision of the Copyright Act, 1957.
- h. Without prejudice, the AO and DRP erred in holding that the sale of shrink wrapped and off-the-shelf software provides 'exclusive use' or 'exclusive right to use' to its customers in the software.
 - i. The AO and the DRP failed to appreciate the Appellant's contention that the subject receipts represents price for sale of shrink wrapped and off-the-shelf software and are not in the nature of royalty income and in doing so, have not appreciated the fact that it would result in business income in the hands of the Appellant and not taxable in India in the absence of a Permanent Establishment or a business connection of the Appellant in India.
 - j. That the AO and the DRP erred in law in relying on the decision of the Hon'ble High Court of Karnataka in the case of CIT v. Samsung Electronics Company Ltd. (reported in 345 ITR 494) and disregarding the fact that the Appellant in the present case is engaged in the business of reproduction and distribution of software, whereas the assessee in the above case was engaged in the business of development of computer software.
 - k. That in any event, the decision in the case of Samsung (supra) is not applicable to the facts of the Appellant, which the AO and the DRP failed to appreciate.
 - l. That the other decisions relied upon by the AO to hold against the Appellant are distinguishable on facts.
 - m. The DRP erred in merely relying on the orders passed by the DRP in the Appellant's own case for previous assessment years, and the order of this Hon'ble Tribunal for the assessment year 2012-13, without appreciating the facts of the present case independently.
 - n. That in any event, the Appellant has preferred an appeal against the order passed by this Hon'ble Tribunal for the assessment year 2012-13 and the same is admitted.

- o. That without prejudice, the AO and DRP ought to have appreciated that notwithstanding the retrospective amendment made to Section 9(1)(vi) of the Act vide the Finance Act, 2012, the definition of 'royalty' under the India-Ireland DTAA has not undergone any change and that, therefore, the beneficial provisions of the DTAA would continue to apply in the Appellant's case.

3. **Initiation of penalty proceedings**

That the AO erred in initiating penalty proceedings under Section 270A of the Act.

The Appellant craves leave to add to or alter, by deletion, substitution or otherwise, the above grounds of appeal, at any time before or during the hearing of the appeal.

4. **Relief**

- a. The Appellant prays that the appeal may be allowed and the impugned final assessment order be set aside, in the interests of justice and equity.”

2. The assessee company Quest Software International Limited (QSIL) [formerly known as Dell Software International Ltd.] is a foreign company incorporated under the laws of Ireland and a tax resident of Ireland. The ultimate holding company of QSIL is Dell Software Inc (Dell USA). Dell US (Quest US) generated revenues by licensing software products, principally on a perpetual basis and by providing support, maintenance and implementation services for the products and QSIL had entered into the distribution agreement with QSCL.

2.1 The contention of the Id. AR is that the issue of treatment of income from sale of off-the-shelf software as 'royalty' is already covered in favour of the assessee by the judgment of the Hon'ble High Court of Karnataka in the case of *Dell Softwar International Ltd. v. ITO & Anr. in ITA No.1002/2017 dated 30.03.2021* wherein it was held as under:-

“ 3. When the matter was taken up today, learned counsel for the assessee submitted that the issue involved in this appeal has been put to rest in view of the decision rendered by the Supreme Court in **Civil Appeal Nos.8733-8734/2018** between **ENGINEERING ANALYSIS CENTRE OF EXCELLENCE PRIVATE LIMITED VS. THE COMMISSIONER OF INCOME TAX & ANOTHER**, vide order dated **02.03.2021** and the issue involved in this appeal has been answered against the Revenue and in favour of the assessee.

4. Learned counsel for the Revenue was unable to dispute the aforesaid submission.

5. For the reasons assigned in the aforesaid judgment rendered by the Supreme Court in Civil Appeal Nos.8733-8734/2018 vide order dated 02.03.2021, the substantial questions of law involved in this appeal are answered in favour of the assessee and against the Revenue.

6. In the result, the order dated 07.07.2017 passed by the Income Tax Appellate Tribunal is hereby quashed. In the result, the appeal is allowed.”

3. The Tribunal in assessee's own case for the AY 2016-17 in IT(IT)A No.2531/Bang/2019 by order dated 27.07.2021 following the Hon'ble Supreme Court judgment in *Engineering Analysis Centre of Excellence P.Ltd. (supra)* held as follows:-

“4. Aggrieved by the final assessment, the assessee has preferred this appeal before the Tribunal. At the very outset, the learned Counsel for the assessee submitted that the issue in question is squarely covered in favour of the assessee by the judgment of the Hon'ble Apex Court in the case of *Engineering Analysis Centre of Excellence P.Ltd. v. CIT reported in [2021] 432 ITR 471 (SC)*. The learned Departmental Representative was not able to controvert the submissions made by the learned Counsel for the assessee. In view of the judgment of the Hon'ble Apex Court, which is identical to the facts of this case, we hold that the payment of Rs.42,96,49,035 received by the assessee-

company would not constitute royalty and cannot be brought to tax. It is ordered accordingly.”

4. Thus, the Id. AR submitted that the above precedents are binding which shall be followed.

5. The Id. DR submitted that in this case the assessment year is 2017-18 and the issue may be remitted to the AO to examine the relevant agreements so as to decide the issue in the light of the Supreme Court judgment in *Engineering Analysis Centre of Excellence P.Ltd. (supra)*.

6. We have heard both the parties and perused the material on record. The assessee relied on the order of the Tribunal in its own case for the AY 2016-17 (*supra*). The Id. AR also relied on the judgment of Hon'ble Supreme Court in the case of the case of *Engineering Analysis Centre of Excellence Private Limited v. CIT, 432 ITR 471 (SC)*. The Hon'ble Supreme Court in this case has examined the question whether the payments made to non-resident software suppliers is “royalty” and hence TDS u/s. 195 of the Act was required to be deducted on those payments or not. The Hon'ble Supreme Court examined this question considering four types of situations, which has been narrated as under:-

“4. The appeals before us may be grouped into four categories:

- (i) The first category deals with cases in which computer software is purchased directly by an end-user, resident in India, from a foreign, non-resident supplier or manufacturer.
- (ii) The second category of cases deals with resident Indian companies that act as distributors or resellers, by purchasing computer software from foreign, non-resident suppliers or manufacturers and then reselling the same to resident Indian end-users.

- (iii) The third category concerns cases wherein the distributor happens to be a foreign, non-resident vendor, who, after purchasing software from a foreign, non-resident seller, resells the same to resident Indian distributors or endusers.
- (iv) The fourth category includes cases wherein computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, nonresident suppliers to resident Indian distributors or end-users.”

7. The Hon'ble Supreme Court analysed sample agreements in respect of all the four categories and gave the following finding:-

“45. A reading of the aforesaid distribution agreement would show that what is granted to the distributor is only a non-exclusive, non-transferable licence to resell computer software, it being expressly stipulated that no copyright in the computer programme is transferred either to the distributor or to the ultimate end-user. This is further amplified by stating that apart from a right to use the computer programme by the end-user himself, there is no further right to sublicense or transfer, nor is there any right to reverse-engineer, modify, reproduce in any manner otherwise than permitted by the licence to the end-user. What is paid by way of consideration, therefore, by the distributor in India to the foreign, non-resident manufacturer or supplier, is the price of the computer programme as goods, either in a medium which stores the software or in a medium by which software is embedded in hardware, which may be then further resold by the distributor to the end-user in India, the distributor making a profit on such resale. **Importantly, the distributor does not get the right to use the product at all.**

46. When it comes to an end-user who is directly sold the computer programme, **such end-user can only use it by installing it in the computer hardware owned by the end-user and cannot in any manner reproduce the same for sale or transfer, contrary to the terms imposed by the EULA.**

47. In all these cases, the "licence" that is granted vide the EULA, is not a licence in terms of section 30 of the Copyright Act, which transfers an interest in all or any of the rights

contained in sections 14(a) and 14(b) of the Copyright Act, but is a "licence" which imposes restrictions or conditions for the use of computer software. Thus, it cannot be said that any of the EULAs that we are concerned with are referable to section 30 of the Copyright Act, inasmuch as section 30 of the Copyright Act speaks of granting an interest in any of the rights mentioned in sections 14(a) and 14(b) of the Copyright Act. The EULAs in all the appeals before us do not grant any such right or interest, least of all, a right or interest to reproduce the computer software. In point of fact, such reproduction is expressly interdicted, and it is also expressly stated that no vestige of copyright is at all transferred, either to the distributor or to the end-user. A simple illustration to explain the aforesaid position will suffice. If an English publisher sells 2000 copies of a particular book to an Indian distributor, who then resells the same at a profit, no copyright in the aforesaid book is transferred to the Indian distributor, either by way of licence or otherwise, inasmuch as the Indian distributor only makes a profit on the sale of each book. Importantly, there is no right in the Indian distributor to reproduce the aforesaid book and then sell copies of the same. On the other hand, if an English publisher were to sell the same book to an Indian publisher, this time with the right to reproduce and make copies of the aforesaid book with the permission of the author, it can be said that copyright in the book has been transferred by way of licence or otherwise, and what the Indian publisher will pay for, is the right to reproduce the book, which can then be characterised as royalty for the exclusive right to reproduce the book in the territory mentioned by the licence.”

8. After analysing the provisions of Income tax Act, provisions of DTAA, the relevant agreements entered by the assesseees with non-resident software suppliers, provisions of Copy right Acts, the circulars issued by CBDT, various case laws relied upon by the parties, the Hon'ble Supreme Court concluded as under:-

“CONCLUSION

168. Given the definition of royalties contained in Article 12 of the DTAAs mentioned in paragraph 41 of this judgment, it is clear that there is no obligation on the persons mentioned in

section 195 of the Income-tax Act to deduct tax at source, as the distribution agreements/EULAs in the facts of these cases do not create any interest or right in such distributors/end-users, which would amount to the use of or right to use any copyright. **The provisions contained in the Income-tax Act (section 9(1)(vi), along with explanations 2 and 4 thereof), which deal with royalty, not being more beneficial to the assesseees, have no application in the facts of these cases.**

169. Our answer to the question posed before us, is that the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in section 195 of the Income-tax Act were not liable to deduct any TDS under section 195 of the Income-tax Act. The answer to this question will apply to all four categories of cases enumerated by us in paragraph 4 of this judgment.”

9. It is pertinent to note that the Hon'ble Supreme Court has reversed the decision rendered by Hon'ble Karnataka High Court in the case of *Samsung Electronics Co Ltd (supra)*.

10. A perusal of the decision rendered by Hon'ble Supreme Court would bring out following principles: -

- (a) Relevant DTAA provisions are required to be considered for determining the question whether the payments made by the assessee to non-resident companies for purchase of software are in the nature of Royalty or not.
- (b) Where ever India has entered Double Taxation Avoidance Agreement with the country of non-resident supplier, there is no necessity to refer to the provisions of sec. 9(1)(vi) of the Act for the payments made to the non-resident persons, unless the domestic provisions are beneficial to those persons.

- (c) The agreements entered by the assessee with the non-resident software suppliers are required to be examined to find out whether the "licence" that is granted vide the EULA, is not a licence in terms of section 30 of the Copyright Act, which transfers an interest in all or any of the rights contained in sections 14(a) and 14(b) of the Copyright Act, but is a "licence" which imposes restrictions or conditions for the use of computer software.

11. However, we observe that in the instant case neither the lower authorities nor the Tribunal in the AY 2016-17 have examined the relevant agreements entered into by the assessee with the concerned parties generate these receipts which relate to sale of shrink wrapped and off-the-shelf software. Even before us, no such document has been produced by the assessee. In view of this, it is appropriate to remit the issue in dispute to the file of the Assessing Officer for deciding the comparability of these transactions in the light of the judgment of the Hon'ble Supreme Court in *Engineering Analysis Centre of Excellence Private Limited (supra)*. Accordingly, the issue in dispute is remitted to the Assessing Officer for fresh decision with the above directions.

12. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Pronounced in the open court on this 23rd day of August, 2021.

Sd/-
(BEENA PILLAI)
JUDICIAL MEMBER

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 23rd August, 2021.

/Desai S Murthy/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.