IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B" BENCH: BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE-PRESIDENT AND
SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

ITA. Nos. 802 to 806/Bang/2019
Assessment Years: 2009-10 to 2013-14

M/s. Kennametal Inc., C/o. Kennametal India, 8th /9th Mile, Tumkur Road, Bangalore – 560 073. PAN: AACCK6397B	vs.	The Deputy Director of Income Tax (Intl. Taxn), Circle-1(1), Bangalore.
(Appellant)		(Respondent)

Assessee by	:	Shri K.R. Vasudevan, Advocate
Revenue by	:	Dr. Manjunath Karkihalli, CIT (DR)

Date of Hearing :	11.11.2021
Date of Pronouncement :	09.12.2021

ORDER

PER SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

These filed appeals by assessee directed against the common order of CIT(A) for Assessment Years 2009-10 to 2013-14 dated 13.02.2019.

2. The assessee has raised the grounds those are common in all these appeals. For brevity, we consider the grounds in Assessment Year 2009-10 which reads as follows.

> "*1. The Learned CIT(A) / AO have erred in passing the Order in the manner passed, which is bad in law and erroneous on facts;*
>
> *2. The learned CIT(A)/ AO erred in not appreciating the facts of the case properly and passing the Order without considering all the submissions made, in the right perspective;*

3. The learned CIT(A)/ AO erred in not appreciating that the impugned payments were towards reimbursement of cost for providing IT support service and has no income element

4. The learned CIT(A)/ AO erred in not appreciating that the impugned payments were towards usage of IT Support Services pertaining to every phase of business comprising various components like system development 86 maintenance, computer operations and support, providing telecommunication and network facilities, infrastructure development, application service subscription, desktop and helpdesk services, electronic mail services, data warehousing services and also such other support services to all the group entities. Out of the total IT Support services, hardly 5 % of it is towards annual fee for usage of licenses;

5. The learned CIT(A)/ AO erred in holding that the payment towards SAP maintenance charges as " Royalty" and the payment towards other IT support services as "Fees for Technical services", while no such distinction is discernable on facts;

6. The learned CIT(A)/ AO erred in not appreciating that the impugned payments have been accepted by Revenue as "reimbursement of cost" in the hands of the service recipient;

7. The learned CIT(A)/ AO erred in not appreciating that the characterization of a transaction cannot be different in the hands of the "service provider" and "service recipient" and have erred in holding the transaction as "Royalty" and/ or "Fees for Technical services" in the hands of the appellant;

Payments not in the nature of "Royalty"

8. The learned CIT(A)/ AO erred in holding that the reimbursement towards IT support service charges are in the nature of "Royalty";

9. The learned CIT(A)/ AO erred in not appreciating that the impugned payments are not in the nature of "Royalty", both under the provisions of the Income Tax Act, 1961 and the provisions of DTAA;

9. The learned CIT(A)/ AO erred in characterizing the impugned payments as "Royalty" only because the costs were allocated among the users on the proportion of license users without appreciating that the allocation key cannot be a basis for characterizing the services;

10. The learned CIT(A)/ AO erred in holding that the IT support services were ancillary to the provision of SAP licenses and erred in holding the entire payment to be in the nature of "Royalty";

11. The learned CIT(A) / AO erred in holding the impugned payments to be "Royalty" towards us of SAP software, even while giving a finding that the expenditure is not in any way directly linked to the use of SAP software, clearly showing a contradiction between the finding of fact and the conclusion arrived at;

12. The learned CIT(A)/ AO erred in applying the decision rendered in the case of software license distributor, whose facts are very different from that of the appellant;

13. The learned CIT(A)/ AO erred in concluding that the impugned payments are in the nature of "Royalty" merely because the recipient of service has deducted tax at source, without appreciating that deduction of tax at source cannot be a determinative test of the character of the transaction;

Payments not in the nature of "Fees for Technical Services (FTS)"

14. The learned CIT(A)/ AO erred in holding that the IT support services are ancillary to the provision of SAP software and are in the nature of "FTS";

15. The learned CIT(A)/ AO erred in holding that the IT support services are in the nature of "Included services" and hence the payments are "FTS";

16. Without prejudice to the above, the appellant submits that Surcharge and ECS are not applicable where the rate as per DTAA is adopted and therefore needs to be excluded from tax payable computation.

The appellant submits that each of the above grounds/sub-grounds are independent and without prejudice to one another.

The appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Commissioner of Income Tax (Appeals) decide the appeal according to law.

The appellant prays accordingly."

3. The facts of the case are that in these Assessment Years, Kennametal Inc. being a non resident company vide service agreement dated 01.07.2005 has provided Information Technology Services to its subsidiary, Kennametal India Ltd. ("KIL") for which it has received payment from KIL. However, the same was not offered for tax by the present assessee company and tax

deducted at source by KIL was claimed as refund in the return of income by the present assessee. However, the AO was of the opinion that amount received from KIL are mainly in the nature of royalty. The assessee acquired license for the software SAP from SAP AG, Germany and this included onetime cost as well as recurring cost. The assessee has a centralized data centre in USA which houses the server that caters to SAP access and also provides the various services.

4. On this CIT(A) observed as under:

i) 100% of the IT expenses are for maintenance and running of ERP software and ancillary systems, which are allocated to KIL on per user basis (Page 11 of CIT(A) order)

ii) The appellant has received payment for the renting of licensed software programmes, in terms of the Copyright Act (Page 16 of CIT(A) order)

iii) The receipt for allowing use of software is held to be Royalty under IT Act as well as DTAA (Page 16 to 22 of CIT(A) order)

iv) Taxation for payment received for software use is Royalty, as decided by the Hon'ble Karnataka High Court in the case of Samsung Electronics Ltd (Page 22 to 29 of CIT(A) order)

v) The receipts for allowing the use of software is Royalty, based on other decisions (Para 51 at Page35 of CIT(A) order)

vi) Summary of the CIT(A)'s order in Page 38 to 39 holds that the entire payment is for allowing the use of software & other services is held to be Royalty under IT Act and DTAA

5. As against this, the assessee is in appeal before us. The Ld.AR submitted that

i) The AO had contended that the payments are towards software licenses and for services auxiliary to the use of software. Hence, the AO has held the payments to be "Royalty" and "Fees for Included Services"

ii) However, the CIT(A) has held that the entire payment is for use of software and is Royalty.

iii) Hence, the issue before the Hon'ble ITAT is whether the impugned payments held to be made for use of software is "Royalty" or not.

iv) This issue has been decided by the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence Pvt. Ltd v CIT, & Anr, { (2021) 125 TAXMANN.COM 42 }. Extract from the decision are attached

v) In the said decision, the Hon'ble Supreme Court has held that payment for use of software is NOT Royalty. Hence, the issue in these appeals is squarely covered by the above decision of Hon'ble SC.

vi) As regards the AO's contention that these payments constitute "Fees for Included Services", the Hon'ble Karnataka High Court, in the case of De Beers India Minerals Pvt Ltd., { (2012) 21 TAXMANN.COM 214 } has explained the meaning of "Make

available" to qualify as "Fees for Included Services". It has been held that there should be a transfer of technology and that technology should be made available to the transferee/service recipient in order for the services to be considered to have been 'made available'. (Para 22 at Page No. 38 of the decision is attached)

vii) Even as per the AO, the services are supplementary to the use of SAP software and there is no claim of transfer of technology. As such, the payments will not come within the purview of "Fees for Included Services" under India-USA DTAA."

The Ld.AR relied on the judgement of Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence Pvt.Ltd. Vs. CIT & Anr., reported in 432 ITR 471 (SC.)

6. Now the Ld.DR relied on the order of the lower authorities. He also submitted that the department have no occasion to examine the issue in the light of the judgment of Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence Pvt. Ltd. vs. CIT & Anr. (2021) 125 taxmann.com 42 and the issue may be remitted to the file of AO to examine the issue in the light of above judgment.

7. We have heard the rival submissions. Similar issue came for consideration before this Tribunal rendered in the case of M/s. World Courier (India) Pvt. Ltd. vs. ACIT in ITA Nos. 1727, 1577/Bang/2017 dated 11.08.2021, wherein held that

"*11. We have carefully considered the rival submissions, perused the order of the AO and Ld. CIT(A) and the paper book filed on behalf of*

the assessee. We have also considered the various decisions cited before us. We find the issue to be decided in the grounds raised by the assessee is in relation to taxability of payment in question in India in the hands of the recipient. The decision of Hon'ble Karnataka High Court in the case of CIT vs. Samsung Electronics Ltd. 345 ITR 494 on the basis of which the revenue authorities concluded that the payment in question is in the nature of royalty, now stand overruled by the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd. (2021) 125 Taxmann.com 42 (SC). The Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd. (2021) 125 Taxmann.com 42 (SC) held that A copyright is an exclusive right that restricts others from doing certain acts. A copyright is an intangible right, in the nature of a privilege, entirely independent of any material substance. Owning copyright in a work is different from owning the physical material in which the copyrighted work may be embodied. Computer programs are categorised as literary work under the Copyright Act. Section 14 of the Copyright Act states that a copyright is an exclusive right to do or authorise the doing of certain acts in respect of a work, including literary work. The Hon'ble Court took the view that a transfer of copyright would occur only when the owner of the copyright parts with the right to do any of the acts mentioned in section 14 of the Copyright Act, 1957(Copyright Act). In the case of a computer program, section 14(b) of the Copyright Act, speaks explicitly of two sets of acts:

1. The seven acts enumerated in sub-clause (a); and
2. The eighth act of selling or giving of commercial rental or offering for sale or commercial rental any copy of the computer program.

The seven acts as enumerated in section 14(a) of the Copyright Act, in respect of literary works are:
1. To reproduce the work in any material form, including the storing of it in any medium electronically;
2. To issue copies of the work to the public, provided they are not copies already in circulation;
3. To perform the work in public, or communicate it to the public;
4. To make any cinematographic film or sound recording in respect of the work;
5. To make any translation of the work;
6. To make any adaptation of the work; and
7. To do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (1) to (6).

The court held that a licence from a copyright owner, conferring no proprietary interest on the licensee, does not involve parting with any copyright. It said this is different from a licence issued under section 30 of the Copyright Act, which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act.

What is 'licensed' by the foreign, non-resident supplier to the distributor and resold to the resident end-user, or directly supplied to the resident end-user, is the sale of a physical object which contains an embedded computer program. Therefore, it was a case of sale of goods. The payments made by end-users and distributors are akin to a payment for the sale of goods and not for a copyright license under the Copyright Act. The decision of the Hon'ble Karnataka High Cour in the case of CIT Vs. Samsung Electronics Co. Ltd. (2011) 16 taxmann.com 141 (Karn.), on which the revenue authorities placed reliance in making the impugned addition stood overruled by the Hon'ble Supreme Court.

12. On the question whether the provisions of the Act can override the provisions of the DTAA, the Hon'ble Court held that Explanation 4 was inserted in section 9(1)(vi) of the ITA in 2012 to clarify that the "transfer of all or any rights" in respect of any right, property, or information included and had always included the "transfer of all or any right for use or right to use a computer software". The court ruled that Explanation 4 to section 9(1)(vi) expanded the scope of royalty under Explanation 2 to section 9(1)(vi). Prior to the aforesaid amendment, a payment could only be treated as royalty if it involved a transfer of all or any rights in copyright by way of license or other similar arrangements under the Copyright Act. The court held that once a DTAA applies, the provisions of the Act can only apply to the extent they are more beneficial to the taxpayer and therefore the definition of 'royalties' will have the meaning assigned to it by the DTAA which was more beneficial. It was held that the term 'copyright' has to be understood in the context of the Copyright Act. The court said that by virtue of Article 12(3) of the DTAA, royalties are payments of any kind received as a consideration for "the use of, or the right to use, any copyright "of a literary work includes a computer program or software. It was held that regarding the expression "use of or the right to use", the position would be the same under explanation 2(v) of section 9(1)(vi) because there must be, under the licence granted or sales made, a transfer of any rights contained in sections 14(a) or 14(b) of the Copyright Act. Since the end-user only gets the right to use computer software under a non-exclusive licence, ensuring the owner continues to retain ownership under section 14(b) of the Copyright Act read with sub-section 14(a)(i)-(vii), payments for computer software sold/licenced on a CD/other physical media cannot be classed as a royalty.

13. As contended by the learned DR, neither the AO nor the CIT(A) had the benefit of the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd.(supra) and therefore in all fairness, the issue should be remanded to the AO to examine the terms of the agreement under which right were granted to the Assessee in the light of the provisions of the DTAA as to whether the same would amount to royalty. We accordingly remand the issue

to the AO. The AO will afford opportunity of being heard to the Assessee in the set aside proceedings. The appeal of the Assessee is accordingly treated as allowed for statistical purpose.

14. ITA No.1727/Bang/2017 : In this appeal, the issue to be decided is as to whether the AO is justified in disallowing a sum of Rs.1,15,68,449/-being software charges on the ground of non-deduction of tax at source. The facts and circumstances under which this addition is made by the AO under section 40a(ia) of the Act are identical to the facts and circumstances as it prevailed in Assessment Year 2014-15. We have already remanded the issue to the AO for fresh consideration with certain directions. The said directions and decisions will equally apply to the present Assessment Year also. We hold and direct accordingly. The other issues raised in the grounds of appeal were not pressed by the learned Counsel for the assessee. The appeal of the Assessee is accordingly treated as partly allowed for statistical purpose.

15. In the result, the appeal for AY 2014-15 is treated as allowed for statistical purpose while the appeal for AY 2012-13 is treated as partly allowed for statistical purposes."

8. In view of the above order of Tribunal, the issues raised by assessee are remitted to the file of AO to examine the terms of the agreement dated 01.07.2005 under which rights are granted to the subsidiary and in the light of the DTAA as to whether the same would amount to Royalty. The AO will afford opportunity of being heard to the assessee in proceedings.

8.1 In the result, all the five appeals filed by the assessee are partly allowed for statistical purposes.

Order pronounced in the open court on 09th December, 2021.

Sd/-	Sd/-
(N.V. VASUDEVAN)	(CHANDRA POOJARI)
VICE-PRESIDENT	ACCOUNTANT MEMBER

Dated: 09th December, 2021.
/MS/

Copy to

1. The Appellant
2. The Respondent
3. CIT(A)
4. Pr. CIT
5. DR, ITAT, Bangalore.
6. Guard File

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore