IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE

BEFORE SHRI GEORGE GEORGE K, JUDICIAL MEMBER AND
MS. PADMAVATHY S, ACCOUNTANT MEMBER

ITA No.3350/Bang/2018
Assessment year : 2014-15

Synamedia Limited [formerly known as NDS Limited] Block 9A & 9B, Pritech Park, Survey No.51-64/4, Sarjapur Outer Ring Road, Bellandur Village, Bengaluru-560 103. PAN –AABCN 2524 L	Vs.	The Dy. Commissioner of Income-tax (Intl. Taxation), Circle-1(2), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri Sharath Rao, Advocate
Revenue by	:	Shri Muzaffar Hussain, CIT(DR)

Date of hearing	:	09.02.2022
Date of Pronouncement	:	14.02.2022

O R D E R

Per Padmavathy S, Accountant Member

This appeal by the assessee is directed against the order of the DCIT(Intl. Taxation), Circle-1(2), Bengaluru dated 23/10/2018 passed u/s 143(3) r.w.s 144C of the Income-tax Act (the Act) for the asst. year 2014-15.

2. The assessee raised the following grounds before us.

"1. The learned AO/DRP have erred in law and in fact, in treating the receipts pertaining to licensing of software by the Appellant to be in the nature of 'royalty' as defined under the provisions of the Act read with the Double Taxation Avoidance Agreement entered into between India and United Kingdom ('DTAA').

2 The learned AO/DRP have erred in law and fact, in allocating a portion of receipts from sale of hardware as pertaining to software embedded therein and treating the same as ioyalty' as defined under the provisions of the Act and DTAA.

3. The learned AO/DRP has erred in law and in fact, in treating the receipts on account of rendering of support services to be in the nature of 'Fees for Technical Services as defined under the provisions of the Act read with the DTAA.

4. The learned AO/DRP has erred in law and in fact, in treating the difference between receipts as submitted by the Appellant and receipts as per Form 26AS / details obtained under section 133(6) from the customers of the Appellant as royalty/FTS.

5. The learned AO has erred in law by levying interest of INR 5,40,68,706 under section 234A and INR 16,52,09,935 under section 234B of the Act, on account of the adjustments proposed to the return of income."

The brief facts of the case

3. The assessee Synamedia Ltd., [formerly known as NDS Ltd.,] is a company incorporated in US that provides open end-to-end digital

technology services to digital pay television platform operators. The company has expertise in the area of providing conditional access system, interactive systems and other software solutions as well as integration and support services for digital pay TV networks. For the asst. year 2014-15, return of income was filed on 31/3/2016 declaring Nil income and claiming refund of Rs.24,61,00,160/-. The case was selected for scrutiny and notice u/s 143(2) of the Act dated 27/9/2016 was issued and served. During the course of assessment, the case was referred to the DCIT, Transfer Pricing for determination of arms length price for the international transaction entered into by the assessee with its associated enterprises. The TPO accepted the ALP determined by the assessee in support of the international transaction entered into by the assessee with its AE. Subsequently, the AO issued a draft assessment order u/s 143(3) r.w.s 144C of the Act determining a total income of Rs.363,30,10,531/-. The assessee filed an appeal before the DRP, where the DRP confirmed the additions made by the AO. The AO passed the final order making the following additions:-

i. Receipts pertaining to licence of software regarded as royalty under the provisions of the Act or under the DTAA Rs.138,48,63,866/-
ii. Software receipts embedded in hardware as regarded as royalty chargeable to ax under the Act or under the DTAA – Rs.137,38,81,795/-
iii. Receipts on account of rendering support services regarded as FTS under the Act or under the DTAA – Rs.60,15,00,919/-.

iv. Difference in receipts as per 26AS and receipts as submitted by the assessee – Rs.27,27,63,951/-

4. Aggrieved by the order of the AO, the assessee filed an appeal before us.

5. Before us the Ld AR limited his arguments to the below issues for our consideration

(i) Whether the AO is right in treating the receipts towards software license as 'royalty'
(ii) Whether the AO is right in allocating a portion (33%) of the receipt from sale of hardware as pertaining to software thereby is a 'royalty
(iii) Whether the AO is right in treating the receipts on account of provision of support services as 'fees for technical services (FTS)'

6. The Ld.AR submitted that the issues raised above for the current assessment year is covered by the decision of co-ordinate bench in assessee's own case in ITA No.363, /Bang/2017 for the asst. year 2006-07, ITA No.504/Bang/2017 for the asst. year 2012-13 and 505/Bang/2017 for the asst. year 2013-14 and ITA No.255/Bang/2015 for the asst. year 2010-11 vide order dated 12/11/2021. The Ld AR also submitted that the Tribunal has allowed the appeal in favour of the assessee with regard to all the issues and had issued directions to the AO accordingly.

7. The Ld DR did not have any counter arguments against the submissions made

8. We heard both the parties and perused the materials on record. We notice that in earlier assessment years in assessee's own case (supra) the Tribunal has considered the same issues as mentioned above. We also notice that the Tribunal in the order has analyzed the terms of the license agreements entered into by the assessee with its customers and it is brought to our attention that during the year under consideration for this appeal, the receipts in the hands of the assessee are received under the same agreements. The Tribunal in assessee's own case (supra) after analyzing the terms of the agreement concluded that the terms of agreement in assessee's case are similar to those considered by the Hon'ble Supreme Court in the case of case Engineering Analysis Centre of Excellence (P) Ltd. (2021) 125 Taxmann.com 42 (SC) / 432 ITR 471 (SC). Considering the fact that the Hon'ble Supreme Court in Engineering Analysis Centre of Excellence (P) Ltd (Supra) allowed the appeal in favour of the assessee taking into account those terms of the agreement, the decision of the Apex Court is directly applicable to the current appeal also.

9. With regard to issue (i) where the receipts towards software license treated as 'royalty' the Tribunal has held that

27. The terms of the licence in the present case does not grant any proprietory interest on the licencee and there is no parting of any copy right in favour of the licencee. It is non-exclusive non-tranferrable licence merely enabling the use of the copy righted product and does not create any interest in copy right and therefore the payment for such licence would not be in the nature of royalty as defined in DTAA. We therefore hold that the sum in question cannot be brought to tax as royalty.

10. The next issue raised by the assessee is the treatment of software receipts embedded in hardware as regarded as 'royalty'. This issue is also considered by the Tribunal in assessee's own case (supra) where the Tribunal has held that

24. The terms of the other licence agreement between the various parties have not been set out in the order of assessment though the copies of the same are available in the Paper Book. The terms of the agreement are clearly similar to the terms of the agreement which the Hon'ble Supreme Court analyzed in the case of Engineering Analysis. We shall anlyse the terms of the Agreement between the Assessee and Bharati Telemedia as a sample. Techinical and commercial proposal given by the Assessee alongwith the STB provides technical specifications for the engineering of the relevant systems. That by itself cannot be the basis to conclude that there has been use of any copyright or that technical services have been provided. This is like providing a technical and user manual describing the system and does not imply granting of any copyright rights or transferring technical knowledge. The software is only licensed for use without granting any license

over the copyrights [see Article 3 – 3.01 – clause (a) at Page 58]. There are further restrictions on such license like (a) no copies to be made (b) no reverse engineering decompiling or otherwise (c) no sub-license rights (see clause 3.02 at Page 59). The clauses are typical clauses in a Software End User License Agreement (EULA) as analysed by Honble Supreme Court in the Engineering Analysis case (see paras 45 – 47 of the SC judgment). The Viewing cards, Set Top Boxes and the software to run it are together an integrated system. This is similar to the fourth category examined by the Supreme Court. The Supreme Court approved the judgment of Delhi High Court (para 118) in the cases of Ericsson and Nokia which dealt with the sale of integrated telecom equipment with embedded software (para 110). The AO also acknowledges that STB, Viewing Card and embedded software is an integrated system. There were certain inferences drawn by the AO based on the FAO given along with the STB. Even if software is licensed and not sold, it is akin to sale based on real nature of transaction. Bharti is just a distributor of Assessee's products (ie, integrated system). Distributor is buying products for onward sale – para 45 of SC judgment. Use of hardware and software to run are key characteristics of an integrated system. Even if it is licensed, the real nature is that of a sale as per para 51 of SC judgment (one has to look at the real nature of the transaction upon reading the agreement as a whole as laid down by the Hon'ble Supreme Court and para 52 of SC judgment (licensing is akin to sale – reference to SC judgment in TCS case). With reference to paras 4.1 to 4.8 of FAO, it is clear from para 73 of SC judgment that granting of license has to be granting license over copyright rights as per section 14(b) read with 14(a) of Copyright Act. In para 97 the Hon'ble Supreme Court has

observed that under software license agreement, customer is licensed to only use the software as such and not the copyrights in the software, therefore granting of license in such cases does not amount to royalty (Assessee's case is similar – see Article 3.01 and 3.02 of the Agreement). In para 109 of SC judgment, it has been specifically laid down that it is wholly incorrect to say that license in software EULA is license to use copyrights. In para 117 for overall conclusions of SC in the context of distinction between license over copyright and license to use copyrighted product – specifically para 117(v), the Hon'ble Supreme Court has held that even if fee schedule refers to royalty payment, this is consideration for purchase of an integrated system. One has to look at the overall agreement and the real nature of the transaction (para 51 of SC judgment). On the AO's reference in para 4.4 of FAO as license being for use of IPR over viewing cards and software is incorrect since as per Article 3.01 and 3.02 (page 58-59 of paper book), license is for simplicitor use of the software, with several restrictions. Also, as per clause 3.04 (No license to accessed materials) and clause 3.05 (Ownership), no license whatsoever is granted over using the IPR in the software. License is to only use software to enable using the accompanying hardware, as part of an integrated system. Aspect of training referred to in para 4.5 of FAO does not advance AO's case since software and hardware are part of an integrated system akin to supply of goods. When training is provided to use it, it is similar to initial training provided by a vendor of any high end electronic or integrated equipment (for example, telecom equipment as examined by Delhi HC in Ericsson case). This doesn't amount to training in furtherance of license of copyright. With reference to para 4.6 on provision of operations and maintenance manual, this is akin to

provision of a User Manual which describes the functioning of any equipment. For example, every sale of a TV comes with an operations and user manual. With refence to para 4.7, the providing of AMC services like repair, etc is akin to post-sale standard AMC services provided in the case of any sale of equipment. This AMC service does not in any way make the original transaction a royalty transaction. Since the AY is AY 2010-11 (ie, prior to the Finance Act, 2012 amendment by way of inserting Explanation 4 to Section 9(1)(vi) of the Act, as per the SC in its judgment, the Finance Act, 2012 amendment has to be read as expanding the scope of royalty with prospective effect from the Assessment Year 2013-14 (After FA, 2012 was enacted) and cannot be upheld as clarificatory so as to apply retrospectively for previous assessment years (para 73 - 74, 78 and 79). Therefore, the payments made under the customer contracts are not be treated as "royalty" under section 9(1)(vi) of the Act itself for the subject AY 2010-11, even without reference to the DTAA. Under the DTAA, clearly these are not "royalty" payments under Article 12 of the India – UK DTAA as held by the SC (UK DTAA has also been examined by the SC para 40.

25. As already observed in the earlier paragraph, 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. We have already set out the terms of the Agreement under which software in question was sold by the Assessee to its distributions and the terms of the EULA. The same are identical to the case decided by the Hon'ble Supreme Court and hence the ratio laid down therein would squarely apply to the present case also.

26. 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 the 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.

11. The last issue of receipts on account of rendering support services regarded as FTS, is also considered by the Tribunal in assessee's own case (supra) and held that

"28. On the question whether the sums in question can be taxed as FTS, we agree with the submissions made by the learned counsel for the Assessee set out in paragraph-18 & 19 of this order and hold that the sums in question cannot be brought to tax as FTS.

29. As far as the question whether the sum which was offered to tax by the assessee and which by virtue of our conclusions as aforesaid cannot be regarded as royalty or FTS and hence cannot be taxable, the Revenue should be directed to not to tax the aforesaid sum also. The first aspect that may require

consideration is as to whether the assessee can seek to lay a claim that the amount offered tax in the return of income is not taxable. On this issue, the law is well settled and the Hon'ble Delhi High Court in the case of Indglonal Investments and Finance Limited Vs. ITO, Writ Petition (Civil) 15639/2006 and 7127/2008 dated 03.06.2011 after considering the decision rendered in the case of CIT Vs. Shelly Products 261 ITR 361 (SC) came to the conclusion that if by mistake or inadvertently or on account of ignorance included in his return of income in income which is not income within contemplation of law, bring the same to the notice of tax authorities and the tax authorities can grant him relief and repay of tax in excess. The Hon'ble Court referred to article 265 of the Constitution of India which provides that there shall be no tax levied or collected except by authority of law. We therefore are of the view that in the light of the discussion in the earlier part of this order regarding taxability of receipts on sale of set-top-box, the amount offered to tax by the assessee which is now found to be not taxable cannot be brought to tax. We hold and direct accordingly and allow the ground of appeal."

12. The order of the DRP in assessee's own case for the assessment 2016-17 dated 31.03.2021 (Page number 1790 to 1803 of Paper Book) was submitted and was taken on record. In the said order we observe that the DRP has considered the identical issues and has issued directions to the AO to delete the additions. With regard to issue of treating receipts pertaining to software license and the receipts towards embedded software as 'royalty' the DRP in para 1.5 of the order had allowed the ground in favour of the assessee following the ratio laid

down by the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd (supra). With regard to treatment of receipts towards Support Services as 'FTS" the DRP in para 2.3 had discussed the provisions Article 13 of India – UK DTAA in addition to placing reliance on the judgment of the Supreme Court and on and held that

> *"The service contract of the assessee with Indian customer is merely a technical and after sales support services. These services are not making available the technical know-how to the Indian Customers. We find that 'make available' clause as per Article 13 is not being satisfied in present case. Therefore the addition made by the AO is deleted. Accordingly this ground is allowed"*

13. We have taken into consideration the materials on record and the binding effect of the order of the coordinate bench of the Tribunal in assessee's own case (supra). Respectfully following the judgment of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd (supra) and the order of the coordinate bench of the Tribunal in assessee's own case (supra), we allow this appeal in favour of the assessee with regard to issues contended before us.

14. In the result, assessee's appeal is partly allowed

Order pronounced in court on 14th February, 2022

Sd/-	Sd/-
(GEORGE GEORGE K)	**(PADMAVATHY S)**
Judicial Member	Accountant Member

Bangalore,

Dated, 14th February, 2022

/ vms /

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.

1. Date of Dictation
   ……
2. Date on which the typed draft is placed
   before the dictating Member …….
3. Date on which the approved draft comes to Sr.P.S
   …….
4. Date on which the fair order is placed
   before the dictating Member ……..
5. Date on which the fair order comes back to the Sr.
   P.S. ……..
6. Date of uploading the order on
   website……..
7. If not uploaded, furnish the reason for doing so
   ……..
8. Date on which the file goes to the Bench Clerk
   ……..
9. Date on which order goes for Xerox &
   endorsement……
10. Date on which the file goes to the Head Clerk
    …….
11. The date on which the file goes to the Assistant
    Registrar for signature on the order
    …….
12. The date on which the file goes to dispatch section
    for dispatch of the Tribunal Order
    …….
13. Date of Despatch of Order.
    ……..