

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

**BEFORE SH. N. K. BILLAIYA, ACCOUNTANT MEMBER
AND
SH. C.N. PRASAD, JUDICIAL MEMBER**

ITA No.527/Del/2021
Assessment Year: 2017-18

Mentor Graphics Ireland Ltd. Plot No.7A/2, Sec-142, Noida, U.P. PAN No.AAGCM6365H (APPELLANT)	Vs	ACIT Circle-2 (2) (1) International Taxation New Delhi (RESPONDENT)
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Appellant by	Sh. Tarandeep Singh, Advocate Sh. Sandeep Yadav, Advocate
Respondent by	Sh. Vizay B. Vasanta, CIT DR

Date of hearing:	19/06/2023
Date of Pronouncement:	21/06/2023

ORDER

PER N. K. BILLAIYA, AM:

This appeal by the assessee is preferred against the order dated 18.03.2021 framed u/s. 143 (3) r.w.s. 144C (13) of the Act.

2. The grievance of the assessee read as under:-

1. *That, on the facts, and in the circumstances of the case, and in law, the orders passed by the Assistant Commissioner of Income Tax, Circle- 2(2)(1), International Taxation, New Delhi [hereinafter referred as the "AO"] and the Dispute Resolution Panel -2 [hereinafter referred as the "DRP"] are bad in law and void ab-initio [herein*

referred to as 'assessment order' and 'DRP order'].

1.1 That, on facts, and in law, the AO has erred in not providing an adequate opportunity of being heard to the Appellant, thereby violating principals of natural justice, while passing the final assessment order under section 143(3)/ 144C of the Act for the AY 2017-18.

2. That, on the facts, and in the circumstances of the case, and in law, AO / DRP have erred in holding / upholding that the consideration received by the Appellant from supply/distribution of its copyrighted software products is chargeable to tax in India as income from 'Royalty' as defined in Article 12 of Agreement for Avoidance of Double Taxation between India and Ireland ('AADT').

3. That, on the facts, and in the circumstances of the case, and in law, AO/DRP have erred in holding/upholding that the consideration received by the Appellant for supply/ distribution of its copyrighted software products is for grant of 'right to use' the copyright in the software and hence, qualifies as royalty.

4. That, on the facts, and in the circumstances of the case, and in law, the AO has erred in not following the principles laid down by the ruling of Supreme Court (SC) of India in the case of Engineering Analysis Centre of Excellence Private Limited wherein it has been held that the amount received by the non-resident from the India distributors/resellers towards supply/sale of software is not taxable in India as Royalty as per the provisions of the Act and AADT.

5. That, on the facts, and in the circumstances of the case, and in law, lower authorities have erred in not following judicial precedents cited by the Appellant, including the decisions pronounced by the Jurisdictional High Court and as also upheld by the SC (supra).

6. That, on the facts, and in the circumstances of the case, the DRP erred in observing that the distributors appointed by the Appellant receive the software and then transmit the same onwards to the end customers.

7. That, on the facts, and in the circumstances of the case, and in law, the AO has erred in not applying an independent mind with respect to the year under consideration and merely reproduced the observations made by the erstwhile AO in

the final assessment passed under section 143(3)/144 of the Act for AY 2015-16.

7.1 That, the observations made by the AO in the impugned assessment order are merely based on conjectures and surmises, rather than on facts and circumstances of the Appellant, i.e. inter alia as under:

(a) The AO has erred in observing from the content/information, downloaded from the global website of the Appellant, that the source code is provided to its customers by the Appellant and royalty would be paid when the revenues of such customers would rise above the threshold limit specified in the terms and conditions of the software program

3. The entire quarrel revolves around the consideration received by the assessee from supply / distribution of its copy righted software products, whether the same is chargeable to tax in India as income from royalty as defined in Article 12 of the agreement for avoidance of double taxation between the India and Ireland. The relevant observations of the AO read as under :-

The assessee company is a company incorporated in Ireland. As per Section 90 of the Income Tax Act, 1961 taxability of a non-resident is to be governed by the provisions of the Act or the DTAA whichever is more beneficial to the assessee.

Payments for software are anyways taxable under Section 9(1)(vi) of the Act. The intention of the legislature to tax software payments was made clear by way of amendments brought in by the Finance Act 2012 by way of insertion of Explanation 4 to Section 9(1)(vi) through which it was clarified that transfer of all or any rights in respect of any right property or information includes and has always included transfer of all or any rights for use or right to use a computer software.

The assessee being a resident of Ireland is eligible to be governed under the DTAA if provisions of DTAA are more beneficial to assessee. The relevant DTAA in this case is India-Ireland DTAA. As per Article 12 of the DTAA, royalties means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft, or for information concerning industrial commercial or scientific experience.

According to the submissions made by the assessee, the payments received for sale of software, without allowing any right to use the copyright in the software, would not be covered within the scope of 'royalty' under the DTAA. The assessee also submitted that the parting of intellectual property rights is inherent in and attached to the software product in favour of the distributors is what is contemplated by the definition of 'royalty' provided in the DTAA. Merely authorizing the distributor to distribute the software products in India and enabling the end-customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to use of or right to use any copyright.

The above submissions of the assessee are not tenable since the definition of royalty under the India Ireland DTAA covers not only the payment made for the right to use any copyright but also the payment made for the right to use any copyright which is embedded in the software supplied by the assessee. Therefore, consideration received from distributors is to be treated as royalty even under the DTAA as the definition covers the consideration received for the use of copyright.

Karnataka High Court in the case of Samsung Electronics Co. Ltd. (345 ITR 494) held that payments made for software would be taxable as royalty even under the DTAA. The Hon'ble High Court held as under:

'If is also clear from the abovesaid analysis of the DTAA, Income-tax Act, Copyright Act that the payment would constitute 'royalty' within the meaning of article 12(3) of the DTAA and even as per the provisions of section 9(1)(vi) as the definition of 'royalty' under section 9(1)(vi) is broader than the definition of 'royalty' under the DTAA as the right that is transferred in the instant case is the transfer of copyright including the right to make copy of software for internal business, and payment made in that regard would constitute 'royalty' for imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill as per clause (iv) of Explanation 2 to section 9(1)(vi). In any view of the matter, in view of the provisions of section 90, agreements with foreign countries (DTAA) would override the provisions of the Act. Once it is held that payment made by the assessee to the nonresident companies would amount to 'royalty' within the meaning of article 12 of the DTAA with the respective country, it is clear that the payment made by the assessee to the non-resident supplier would amount to royalty.

4. This quarrel has now been settled by the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence

Pvt. Ltd. 432 ITR 471 wherein the Hon'ble Supreme Court has grouped the bunch of appeals into four categories as under :-

- 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 end-users.*
- iv) The-fourth category includes cases wherein computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.*

5. The judgment of the Hon'ble High Court of Karnataka in the case of Samsung Electronics Company Limited 345 ITR 494 has been considered at para-10 and after considering other judgment of Hon'ble High Courts the Hon'ble Supreme Court concluded as under :-

167. Given the definition of royalties contained in Article 12 of the DTAA's 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(l)(vi), along with explanations 2 and 4 thereof), which deal with royalty, not being more beneficial to the assessee's, have no application in the facts of these cases.

168. 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.

169. *The appeals from the impugned judgments of the High Court of Karnataka are allowed, and the aforesaid judgments are set aside. The ruling of the AAR in Citrix Systems (AAR) (supra) is set aside. The appeals from the impugned judgments of the High Court of Delhi are dismissed.*

6. Respectfully following the judgment of the Hon'ble Supreme Court (supra) we direct the AO to delete the impugned addition. The appeal of the assessee is allowed.

Order pronounced in the open court on 21.06.2023.

Sd/-
[C.N. PRASAD]
JUDICIAL MEMBER

Sd/-
[N.K. BILLAIYA]
ACCOUNTANT MEMBER

Dated: .06.2023

Neha

Copy forwarded to:

1. Appellant
2. Respondent
3. CITi
4. CIT(A)
5. DR

Asst. Registrar
 ITAT, New Delhi