

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

**BEFORE SHRI G.S. PANNU, HON'BLE PRESIDENT
AND
SHRI SAKTIJIT DEY, VICE PRESIDENT**

ITA No.998/Del/2009
Assessment Year: 2004-05

UT Starcom Inc., India Branch Office, 805, Signature Towers-B, South City-1, Gurgaon, Haryana	Vs.	ACIT, Gurgaon Circle, Gurgaon
PAN :AAACU5017A		
(Appellant)		(Respondent)

With

ITA No.187/Del/2014
Assessment Year: 2005-06

UT Starcom Inc., (Formerly Operating through a branch office in India), 10 th Floor, Signature Towers- B, South City-1, Gurgaon, Haryana	Vs.	ADIT, Circle-3(1), International Taxation, New Delhi
PAN :AAACU5017A		
(Appellant)		(Respondent)

With

ITA No.1858/Del/2009
Assessment Year: 2004-05

DDIT, Circle-3(1) & 3(2) International Taxation, New Delhi	Vs.	UT Starcom Inc., India Branch Office, 805, Signature Towers-B, South City-1, Gurgaon, Haryana
PAN :AAACU5017A		
(Appellant)		(Respondent)

Assessee by	Sh. Saurabh Kansal, Advocate
Department by	Sh. S.N. Pandey, Sr. DR

Date of hearing	05.04.2023
Date of pronouncement	30.06.2023

ORDER

This bunch of three appeals arise out of two separate orders of learned Commissioner of Income Tax (Appeals). Cross appeals for the assessment year 2004-05 have been filed by the assessee and the Revenue. The appeal for assessment year 2005-06 has been filed by the assessee alone.

ITA No.998/Del/2009 (Assessee's Appeal) **AY: 2004-05**

2. In ground no. 1, the assessee has challenged the addition made on certain receipts from Reliance Infocomm Ltd. as royalty, both under the domestic law as well as India – United States of America (USA) Double Taxation Avoidance Agreement (DTAA).

3. Briefly the facts relating to this issue are, the assessee is a non-resident corporate entity and a tax resident of USA. As stated, the assessee is engaged, inter alia, in the business of

developing and marketing of telecommunication equipments and related software. In the relevant assessment year, the assessee had a branch office in India. For the assessment year under dispute, the assessee filed its return of income on 31.10.2004 declaring income of Rs.1,19,62,800/-. Subsequently, the assessee filed a revised return of income on 03.01.2006 claiming credit of excess Tax Deducted at Source (TDS). Be that as it may, in course of assessment proceeding, the Assessing Officer noticed that, though, the assessee had receipts of Rs.7,34,95,361/- from certain Indian companies, however, the assessee had not offered such receipts to tax. When the Assessing Officer called upon the assessee to explain, why such receipts should not be treated as royalty income, as, it was for transfer of right to use the copyright in the software, the assessee submitted that it had sold the software along with hardware (equipments) on outright sale. The assessee submitted that the software sold by the assessee is embedded in the hardware and only for the purpose of operating hardware. Therefore, it cannot be treated as royalty. The Assessing Officer, however, was not convinced. Referring to agreements entered with various Indian telecommunication companies, such as, Bharti Telenet Ltd., Tata Teleservices Ltd.,

and Reliance Infocomm Ltd., the Assessing Officer concluded that the receipts from transfer of right to use the software are in the nature of royalty. Further, he held that since the assessee had a branch office in India and the agreements with the Indian telecommunication companies have been signed in India by an employee of the branch office, the royalty income is connected to the branch office, which constitutes Permanent Establishment (PE) of the assessee in India. Thus, he held that the receipts would be taxable in India, as royalty income, both under section 9(1)(vi) read with section 115A/44D of the Act as well as under the India- USA DTAA, since, the assessee had a PE in India in terms of Article 5 of the treaty. He further observed, even assuming assessee's claim that the receipts are not in the nature of royalty income is correct, still they will be taxable as business profits under Article 7(1) of the treaty, as, the assessee has a PE in India. He held, since the assessee had already claimed all expenses in the return of income attributable to the PE, no further expenses can be deducted from the receipts. Thus, he held that the entire amount of Rs. 7,34,95,361/- is taxable in India.

4. Being aggrieved with the said addition, the assessee preferred an appeal before learned first appellate authority. After considering the submissions of the assessee in the context of facts and materials on record, learned Commissioner (Appeals) held that, insofar as receipts from Bharti Telenet Ltd. and Tata Teleservices Ltd. are concerned, since the assessee has transferred limited, non-transferable, non-exclusive right to use the software solely in the operation of telecommunication equipments purchased by them, such receipts cannot be treated as royalty income. However, he observed, since, the agreement with Reliance Infocomm Ltd. is differently worded, in the sense, that a perpetual, irrevocable, exclusive, unrestricted licence has been granted, the receipts from Reliance Infocomm Ltd. would be taxable as royalty income.

5. Insofar as issue relating to existence of PE and the taxability of the receipts from supply of software as business profit, learned Commissioner (Appeals) held that the receipts from Bharti Telenet Ltd. and Tata Teleservices Ltd. are taxable as business profit under Article 7 of India – USA DTAA as the assessee had a PE in India and such receipts are integrally connected to the PE. Insofar as deductibility of expenses from the profit attributed to the PE,

learned Commissioner (Appeals) directed the Assessing Officer to compute the income of the PE in accordance with judgment of the Tribunal in case of **Motorola Inc. Vs. DCIT [2005] 95 ITD 269 (Delhi ITAT) (SB)**, i.e., on the basis of percentage of net profit on global service applied to Indian sales. Being aggrieved with the order passed by learned first appellate authority, both the assessee and the Revenue are in appeal.

6. We have considered rival submissions and perused the materials on record. Undisputedly, the assessee had entered into agreements with certain India telecommunication companies, such as, Bharti Telenet Ltd., Tata Teleservices Ltd. and Reliance Infocomm Ltd. for supply of basic telecom infrastructure equipment software and assisting them to set up telecommunication network. Basically, these telecom equipments and software were put to use by Indian telecommunication companies to provide basic telecommunication services, value added services, and broad-band services. In sum and substance, the equipments and software were provided to the Indian telecommunication companies to set up mobile telecommunication networks in India. On a perusal of the agreements entered into by the assessee with Indian

telecommunication companies, we do not find any perceptible difference in them. The agreements clearly reveal that the assessee has supplied telecommunication hardware with software. The software provided are embedded in the hardware and are required to operate the telecommunication network. It is a fact on record that learned Commissioner (Appeals) after appreciating the materials placed before him was convinced that the software supplied by the assessee was embedded in the hardware and were required for operating the hardware/equipment. Insofar as agreement with Reliance Infocomm Ltd. is concerned, learned Commissioner (Appeals) has taken a different view by stating that the assessee has transferred a perpetual, irrevocable, exclusive, unrestricted licence. After perusing the agreement with Reliance Infocomm Ltd. as a whole, we find the following features.

- As per clause 15.1.1 of the Agreement, the assessee has granted a perpetual, irrevocable, non-exclusive, unrestricted (within the Broadband Access Reliance Network) unlimited, royalty free license, to use the software.

- Clause 15.1.3 of the Agreement says that software licenses shall not be transferred, assigned, sublicensed by or used by Reliance without the consent of the assessee.
- Clause 15.1.4 of the Agreement says Reliance shall use such software only for the operation of the Broadband Access Reliance Network. Clause 15.1.4 puts a condition that the Reliance will not sub-license such software, or modify, decompile, reverse engineer or disassemble or in any other manner decode software furnished as object code for any other reason. It further provides that the Reliance shall not copy the software including firmware except for the purposes of making a limited number of archival copies.
- Clause 15.1.6 of the Agreement says that the Reliance should hold secret and not disclose the software to any person, except to its employees, contractors, agent representatives or Reliance affiliates that are involved in the operation, maintenance of management of the Broadband Access Reliance Network. Clause 15.1.6 provides that in case software licenses are cancelled or finally terminated, Reliance shall return all copies of such software to assessee.

7. Thus, from the terms of the agreement, it is very much clear that the embedded software has been provided to Reliance only for the purpose of operating the telecommunication equipments supplied by the assessee for Broadband Access Reliance Network. The software licence agreement puts various restrictions and conditions on Reliance with reference to usage of this software. The terms of the agreement make it clear that Reliance cannot itself make copy or duplicate, or permit anyone else to do so with regard to any part of the software, or create the source programs or any part thereof from the object programs. Reliance cannot make the software accessible to any person other than its employees, contractors etc. only for the purpose of establishing and operating the Broadband Access Network. Reliance cannot directly or indirectly sell, transfer, offer, disclose, rent, lease (as lessor), or license the software to any third party, except for right to use the software. The agreement further makes it clear that the assessee has not made any independent supply of software to the Indian telecommunication companies. Rather, the assessee has supplied Digital Loop Carrier System (DLC), which is the hardware along with software to operate the hardware.

8. This fact becomes more clear from the definition of product, which means all hardware and software components and subsystems provided by the assessee. Therefore, it is evident that the hardware and software were supplied together as an integral and inseparable package and the hardware and software cannot be operated without each other. Thus, from the aforesaid facts it is very much clear that the assessee has not transferred use or right to use, a copyright of a literary, artistic or scientific work so as to fall within the definition of royalty under Article 12 of India – USA DTAA. In any case of the matter, in our view, the issue is no more *res integra* in view of the decision of Hon’ble Supreme Court in case of **Engineering Analysis Centre of Excellence Pvt. Ltd. Vs. CIT (432 ITR 471)**, wherein, the Hon’ble Supreme court has divided software transactions into following four categories:

- “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 and 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 integral unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.”*

9. In the facts of the present appeal, undoubtedly, the assessee falls within the fourth category. After analyzing the meaning of royalty under the provisions of the Income Tax Act, Copyright Act, and various DTAAAs as well as number of judicial precedents, the Hon’ble Supreme Court finally concluded as under:

“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.”

10. Thus, applying the aforesaid ratio laid down by the Hon’ble Supreme Court, it has to be held that the receipts from Reliance Infocomm Ltd. are not taxable as royalty income, either under the domestic law or India – USA DTAA. More so, when the agreement between the parties makes it clear that the ownership rights over the software remains with the licensor. Thus, for the aforesaid reasons, we hold that the amount received by the assessee from Reliance Infocomm Ltd. is not taxable as royalty income.

11. In ground no. 2, the assessee has challenged the decision of the first appellate authority in holding that certain other receipts, though, not in the nature of royalty, are business profits and are attributable to the PE. As discussed earlier, while deciding the issue whether the receipts from supply of software to Indian telecommunication is in the nature of royalty, learned first appellate authority has held that the receipts from Bharti Telenet Ltd. and Tata Teleservices Ltd. are not royalty but in the nature of business profits and taxable in India as such profits are attributable to the PE. While coming to such conclusion, learned Commissioner (Appeals) observed that the branch office is involved in the following activities:

- i. Identifying potential customers.
- ii. Providing market related information to head office.
- iii. Organizing trade shows and advertisement of new products.
- iv. Providing assistance to customer for importing the telecom product from head office directly.
- v. Post sales support services etc.

12. In this regard, learned Commissioner (Appeals) observed that the branch office in India is engaged in development of software, which is exported to the assessee and were utilized by the head office in the equipments which are marketed in India. Further, he observed, various other bills raised by the branch office were towards marketing, supply, coordination and other services rendered. Thus, according to the first appellate authority, the branch office has been used in not only software development but also in identification of potential customers, providing assistance to them, post sales services etc. Thus, based on such inferences, learned first appellate authority held that the receipts are taxable in India as business profits attributable to the PE. While coming to such conclusion, learned Commissioner (Appeals) also negated assessee's contention that when the transaction between the assessee and branch office are accepted to be at arm's length, no further profit can be attributed to the PE.

13. Before us, learned counsel appearing for the assessee submitted that the primary condition required to be satisfied for invoking Article 7 of the treaty is that both the foreign company and the PE should be conducting same or similar activities in

India. In this context, he drew our attention to Article 7(1) of India – USA DTAA. He submitted in the facts of assessee's case, the conditions of Article 7(1) are not fulfilled as the activities undertaken by the head office in India are completely different to the activities undertaken by the branch office. He submitted, the branch office is merely engaged in providing marketing support services to the head office and development of part of the patches of software for head office. He submitted, the branch office was not, at all, engaged in sale of software in India. Rather, the software developed by the branch office was not saleable to any customers as it is not complete and cannot be used to operate the hardware. Whereas, the head office has sold software to Indian customers, which can operate hardware. Thus, he submitted, the conditions of Article 7(1) are not applicable. He submitted, except development of software patches, all other activities relating to sale of hardware and software have taken place outside India and the sale of hardware and software to the Indian customers is in the nature of offshore supply.

14. He submitted, in such a scenario, when title over the goods has been transferred outside the territory of India, such receipts cannot be taxable in India. In this context, he relied upon a

decision of the Hon'ble Supreme court in case of ***Ishikawajma-Harima Heavy Industries Ltd. Vs DIT [2007] 288 ITR 408 (SC)***. Without prejudice, he submitted, even as per the provisions of the Act, only such part of the income attributable to the operation carried out in India can be taxed in India. Thus, he submitted, the entire receipts, which includes, manufacturing and supply of equipment software from outside India, wherein, there is no involvement of the branch office, cannot be made taxable in India. Proceeding further, he submitted, since the branch office has been remunerated at arm's length by the head office with respect to the activities performed, which has been accepted by the Transfer Pricing Officer (TPO), no further profit can be attributed to the PE. For such proposition, he relied upon a decision of Hon'ble Supreme Court in case of ***DIT (International Taxation), Mumbai vs. M/s Morgan Stanley & Co. Inc., (2007) 7 SCC 1***. Thus, he submitted, the addition made on account of attribution of profit to the PE should be deleted.

15. Learned Departmental Representative strongly relied upon the observations of the Assessing Officer and learned Commissioner (Appeals).

16. We have considered rival submissions and perused the materials on record. We have also applied our mind to the decisions relied upon. Undisputedly, the assessee has sold telecommunication equipments along with software to Indian telecommunication companies. It is also a fact on record that the telecommunication hardware and software were not supplied by the assessee directly to the Indian customers from outside India. Therefore, the issue arising for consideration is, whether the receipts from such supply, though, may be in the nature of business profits, can be attributed to the PE in India. Learned first appellate authority has held that the PE in India is involved not only in providing marketing and support services, but has also sold part of software to the head office, which in turn, was used by the head office in the final product.

17. Keeping in perspective the factual position emerging on record, it can be seen that the agreement for supply of telecommunication equipment along with software was between the head office and the Indian customers. It is also a fact that the telecommunication equipments along with software were supplied from outside India directly to the Indian customers. The payments were also made directly to the assessee by the Indian customers.

Though, there is an allegation by the departmental authorities that the branch office has played a role in respect of such supplies, however, in what manner and to what extent the branch office has played such role is not forthcoming from the observations of the departmental authorities. It appears from record that the branch office has developed a patch of the software, which has been sold to the head office. It may be a fact that the patch of the software developed by the branch office was made part of the complete software, which in turn, got embedded in the hardware supplied to the Indian customers by the head office. However, in our view, such sale of patch of software by the branch office to the head office cannot be linked to the supply of telecommunication equipment and software by the assessee to the Indian customers, as, the branch office has a very limited and restricted role of supplying patch of the software.

18. In any case of the matter, insofar as such supply is concerned and for that matter all other transactions between the branch office and head office have been accepted to be at arm's length, in such a scenario, no further profit attribution can be made to the PE. It is borne out from record that the head office has directly supplied the hardware and software from outside the

territory of India. Neither manufacturing nor any other activities relating to the hardware and software supply has taken place in India. In such a scenario, the profit/income from offshore supply of equipments and software cannot be attributed to the PE, as, only such part of income relating to operation carried out in India can be attributed to the PE and taxed in India.

19. That being the position in law, the entire profits from supply of equipments and software cannot be attributed to the PE. The departmental authorities have not demonstrated in any financial terms, what is the exact role of the PE in earning the receipts and to what extent. Only that part of the receipts, which can be linked to the activities of the branch office, can be brought to tax in India by attributing to the PE. Instead of undertaking any such exercises, the departmental authorities have attributed the entire receipts to the PE, which in our view, is unsustainable. Accordingly, we hold that the receipts from Bharti Telenet Services Ltd. and Tata Teleservices Ltd., even though, may be in the nature of business profits, but cannot be attributed to the PE.

20. In ground no. 3, the assessee has challenged the disallowance of Rs.4,51,292/-, being employees contribution to

Provident Fund (PF) and Employees State Insurance (ESI) paid beyond the due date.

21. We have heard the parties and perused the materials on record. Before us, it is the specific contention of learned counsel for the assessee that the amount in dispute was paid within the grace period provided under the PF and ESI Act. In this context, he relied upon a decision of Hon'ble Madras High Court in case of CIT Vs. The Salem Cooperative Spinning Mills Ltd., TC (A) No. 90 of 2006, judgment dated 7th February, 2006.

22. Having considered the submission of the parties, we direct the Assessing Officer to verify, whether the amount in dispute was remitted to the Government account within the grace period provided under the PF and ESI Act. If on such verification, the Assessing Officer finds assessee's claim to be correct, the addition should be deleted.

23. In addition to the main grounds, the assessee has raised an additional ground, challenging the levy of interest under section 234B of the Act. Since, the additional ground can be decided without fresh investigation in to the facts, we admit it for adjudication.

24. It is the say of the assessee that since it is a non-resident company, it has no liability to pay advance tax, as, the obligation is on the payer to deduct tax at source. For such proposition, learned counsel relied upon a catena of judicial precedents.

25. Having considered rival submissions in the light of judicial precedents cited before us, we accept assessee's claim and hold that no interest under section 234B of the Act can be charged as the assessee, being a non-resident company was not liable to pay advance tax, since, the payer is under an obligation to withhold tax under section 195 of the Act while making payment to the assessee. Accordingly, the Assessing Officer is directed to delete the interest charged under section 234B of the Act.

26. In the result, the appeal is partly allowed.

ITA No. 1858/Del/2009 (Revenue's Appeal)
AY: 2004-05

27. The effective grounds raised by the Revenue are as under:

- 1) *On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that payment received from M/s Bharti Telenet Limited and M/s Tata Teleservices Limited in not taxable as royalty u/s 9(1)(vi) of the Income-tax Act, 1961.*
- 2) *On the facts and circumstances of the case and in law, the Ld. CIT(A) has erred in holding that the payment received from*

M/s Bharti Telenet Limited and M/s Tata Teleservices Limited is taxable as business profit.

3) *On the facts and circumstances of the case and in law, the Ld. CIT(A) has erred in holding that the business profit should be computed in accordance with the judgment of Hon'ble Delhi ITAT in the case of Motorola Inc. V/s DCIT 95 ITD 269 (SB) (Del) i.e. on the basis of percentage of net profit on global sales applied to Indian Sales.*

28. As could be seen from the grounds raised, these are overlapping issues already dealt with in assessee's appeal in ITA No. 998/Del/2009 (supra). While deciding assessee's appeal, we held that the receipts from Indian telecommunication companies cannot be taxed, either as royalty or as business profits in India.

29. In view of the aforesaid, the grounds raised by the Revenue have become infructuous. Grounds are dismissed.

30. In the result, appeal is dismissed.

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AY: 2005-06

31. In ground nos. 1 and 2, the assessee has challenged the attribution of profit to the PE in India in respect of offshore supplies of telecommunication equipments and software. Whereas, in ground nos. 3 and 4 the assessee has raised the

issue of taxability of receipts from software licenses as royalty income.

32. The aforesaid issues are identical to the issues arising in assessee's appeal, being ITA No.998/Del/2009 decided by us in the earlier part of the order. While dealing with the very same issues, we have held that the receipts from sale of software licenses are not in the nature of royalty income. We have also held that, though, such income may be in the nature of business profit, however, no part of which can be attributed to the PE in India. Thus, our decision in the said appeal will apply *mutatis mutandis* to this appeal as well. Grounds are allowed.

33. In the result, appeal is allowed.

34. To sum up, assessee's appeals are allowed, whereas, Revenue's appeal is dismissed.

Order pronounced in the open court on 30th June, 2023

**Sd/-
(G.S. PANNU)
PRESIDENT**

**Sd/-
(SAKTIJIT DEY)
VICE PRESIDENT**

Dated: 30th June, 2023.

RK/-

Copy forwarded to:

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

Asst. Registrar, ITAT, New Delhi