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

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

IT(IT)A No.913/Bang/2019
Assessment year : 2016-17

Informatica LLC, C/o. INfomatica Business Solutions Pvt. Ltd., No.66/1, Bagmane Commez 02, Bagmane Tech Park, C V Raman Nagar, Bangalore – 560 093. **PAN: AACCI 2354Q**	Vs.	The Assistant Commissioner of Income Tax, International Taxation Circle 1(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri T. Suryanarayana, Advocate
Respondent by	:	Shri Pradeep Kumar, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	05.07.2021
Date of Pronouncement	:	05.07.2021

ORDER

Per Chandra Poojari, Accountant Member

This appeal is by the assessee against the order of the Assessing Officer passed u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 [the Act] for the assessment year 2016-17.

2. The assessee has raised the following grounds:-

"1. That the impugned final assessment order passed by the Respondent (hereinafter referred to as 'the AO') pursuant to the directions of the Dispute Resolution Panel (the DRP' for short), to the extent questioned herein, is bad in law and on facts and is, therefore, liable to be set aside by this Hon'ble Tribunal.

2. That the AO erred and the DRP further erred in holding that the payments received by the Appellant for sale of software to Indian resellers/distributors/customers is in the nature of 'royalty' chargeable to tax under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act' for short), and Article 12 of the India-USA Double Taxation Avoidance Agreement (DTAA').

3. That the AO erred and the DRP further erred in failing to appreciate 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 DTAA has not undergone anyoApp,9e and that, therefore, the beneficial provisions of the DTAA would continue to apply in the Appellant's case.

4. That the AO erred and the DRP further erred in holding against the Appellant on the issue of taxability of the payments received by it for sale of software by merely following the orders passed by the Hon'ble High Court of Karnataka in the cases of Samsung Electronics Co. Limited, Sunray Computers Ltd. and Rational Software Corporation Ltd. as well as the order passed by the Authority for Advance Rulings in the case of Citrix Systems Asia Pacific Proprietary Limited, despite the said orders being under challenge before the Hon'ble Supreme Court in C.A. Nos.10109/2013, 10115/2013, 8966/2018 and 8990/2018 respectively.

5. That the AO and DRP overlooked the difference between the right to use a copyrighted article as against the transfer of copyright itself and that in the case of the Appellant, it is the former that has taken place.

6. That the AO and DRP failed to appreciate that access to software wherein a subject matter of copyright is embedded, without the right to exploit the copyright, does not amount to use or right to use the copyright in the copyrighted work.

7. That the AO erred and the DRP further erred in not appreciating that the consideration received by the Appellant for sale of software to Indian resellers/distributors/customers does not constitute payments in respect of a secret process.

8. That the AO and DRP failed to appreciate that since the payment received by the Appellant for sale of software was not to be measured with reference to the productivity or use of the software, it could not be construed as 'royalty'.

9. That the AO erred and the DRP further erred in not following certain decisions delivered by the Hon'ble High Courts of Delhi and Bombay, the Authority for Advance Rulings and various Benches of this Hon'ble Tribunal on the same issue that arises in the Appellant's case.

10. That the AO erred in classifying the consideration received by the Appellant towards support services as royalty / fees for technical services under Article 12 of DTAA. The DRP further erred in rejecting the Appellant's objections by holding that the said payments received by it qualify as royalty as they are for use of a copyright.

11. That the AO erred in considering the higher of the amounts appearing in Form 26AS in certain cases wherever the amount in the Form 26AS are more that the corresponding amounts appearing in the invoice list for a given party.

12. That the AO erred in initiating penalty proceedings against the Appellant under Section 271(1)(c) of the Act.

13. That the impugned final assessment order passed by the AO, to the extent questioned herein, is otherwise unsustainable in law and on facts and is thus liable to be set aside by this Hon'ble Tribunal.

Each of the foregoing grounds is without prejudice to the other and the Appellant craves leave to add to, amend or delete all or any of the above grounds of appeal either before or at the time of hearing."

3. The assessee is a company incorporated in the United States of America and is engaged in the business of developing, manufacturing and distribution of software products. It had entered into agreements with distributors/resellers/customers in India for supplying software products and ancillary support services. The AO treated the same as royalty and charged tax both under the Income-tax Act and DTAA.

4. The same was confirmed by the CIT(Appeals) by following the judgment of the Hon'ble Karnataka High Court in the case of *CIT v. Samsung Electronics, 345 ITR 494 (Karn)*, wherein it was held as follows:-

> "The Supreme Court, in Union of India v. Azadi Bachao Andolan [2003] 263 ITR 705/ 132 Taxman 373, has laid down that provisions of the DTAA prevails over the provisions of the Act if the provisions of the DTAA are more beneficial to the assessee. It is clear on perusal of the definition of 'royalty' under the Act and the DTAA that the definition of 'royalty' is restrictive in the DTAA, whereas the definition of 'royalty' under the Act is broader in its content. Therefore, the definition of 'royalty' in the DTAA is more beneficial to the assessee as according to the assessee, payment is not royalty and, therefore, the royalty in the restricted meaning under DTAA is more beneficial to the assessee and, hence, it is to be found out as to whether the payment made by the assessee would amount to royalty under the clause in the DTAA. Even otherwise, it is clear that if the payment is held to be royalty within the restricted meaning given to the term in the DTAA, naturally, it would also to be covered within the term 'royalty' in the broader meaning of the term 'royalty' under the Act. [Para 16]
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> The dispute between the revenue and the assessee in these cases is whether payments made by the assessee to the non-resident would constitute 'royalty' or 'Income from business' and if it is to be treated as 'Income from business', whether the non-resident is required to have a permanent establishment in India. Further, in the absence of any permanent establishment of the non-resident in India, is there no obligation on the part of the payee, the assessee herein, to deduct tax at source under section 195.

Therefore, the fact that the payments made by the assessee to the non-resident would constitute income of the non-resident is indisputable. However, the dispute is as to whether such income in the hands of the non-resident is to be treated as sale and income from business covered under article 7 of the DTAA with respective countries or whether the payments would amount to royalty in the hands of the non-resident, for which no permanent establishment is required for making payment in India. There is also no dispute that if the payments made by the assessee are held to be royalty and not 'income from business', there is an obligation on the part of the payee, the assessee, to deduct the tax at source and in default, the assessee would be considered as a default assessee. Once there is an obligation to deduct tax at source under section 195, which imposes a statutory right on any person responsible for paying to a non-resident, any interest (not being interest on securities) or any other sum (not being dividend) chargeable under the provisions of the Act, to deduct income-tax at the rates in force unless he is liable to pay income tax thereon as an agent. Payment to non-residents by way of royalty and payment for technical services rendered in India are common examples of sums chargeable under the provisions of the Act to which the aforestated requirement of TDS applies. The tax so collected and deducted is required to be paid to the credit of the Central Government in terms of section 200 read with rule 30 of the Income-tax Rules, 1962. Failure to deduct tax or failure to pay tax would also render a person liable to penalty under section 201 read with section 221. In addition, he would also be liable under section 201(1A) to pay simple interest at 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. Therefore, if the amount is held to be royalty, the other consequences as referred to above would follow. [Para 17]

In view of the definition of 'royalty' given in article 12 of the DTAA, it is clear that the necessary ingredient to be satisfied to find out as to whether the payment would amount to 'royalty' is as follows:-

- payment of any kind received as a consideration for the use of or the right to use, any copyright of literary, artistic or scientific work.

It has been universally accepted that a literary work is entitled to copyright and, wherefore, a literary work is entitled to be registered as copyright. Under section 2(o) of the Copyright Act, 1957, computer software has been recognized as copyright work in India also. [Para 19]

In the instant case, in the software licence agreement, it is averred that customer accepts an individual, non-transferable and non-exclusive licence to use the licensed software program(s) program(s) on the terms and conditions enumerated in the agreement. It is further averred that the customer-assessee shall protect confidential information and shall not remove any copyright, confidentiality or other proprietary rights provided by the non-resident. However, what is granted under the said licence is only a licence to use the software for internal business without having any right for making any alteration or reverse engineering or creating sub-licences. What is transferred under the said licence is the licence to use the software and copyright continue to be with the non-resident as per the agreement, Even as per the agreement entered into with the other distributors as also the end-user licence agreement, it is clear that the distributor would get exclusive non-transferable licence within the territory for which he is appointed and he has got right to distribute via resellers the software, upon payment of the licenses set forth in the agreement only to end-users pursuant to a valid actuate shrink wrap or other actuate license agreement and except as expressly set forth in the said agreement, distributor may not rent, lease, loan, sell or otherwise distribute the software the documentation or any derivative works based upon the software or documentation in whole or in part. Distributor shall not reverse engineer, decompile, or otherwise attempt to derive or modify the source code for the software. Distributor shall have no rights to the software other than the rights expressly set forth in the agreement. Distributor shall not modify or copy any part of the software or documentation. Distributor may not use sub-distributors for further distribution of the software and documentation without the prior consent of actuate. What is charged is the licence fee to be paid by the distributor of the software as enumerated in the agreement. Further, clause 6.01 of the agreement dealing with title states that the distributor acknowledges that actuate and its suppliers retain all rights, title and interest in and to the original, and any copies (by whomever produced), of the software or documentation and ownership of all patent copyright, trademark, trade secret and other intellectual property rights pertaining thereto, shall be and remain the sole property of actuate. Distributor shall not be an owner of any copies of, or any interest in, the software, but rather is licenced pursuant to the agreement to use and distribute such copies. Actuate represents that it has the right to enter into the agreement and grant the licences provided therein and confidentiality is protected. Therefore, on reading the contents of the respective agreement entered into by the assessee with the non-resident, it is clear that under the agreement, what is transferred is only a licence to use the copyright belonging to the non-resident subject to the terms and conditions of the agreement as referred to above and the non-resident supplier continues to be the owner of the copyright and all other intellectual property rights. If is well-settled that copyright is a negative right. It is an umbrella of many rights and licence is granted for making use of the copyright in respect of shrink wrapped software/off-the-shelf software under the respective agreement, which authorizes the end user, i.e., the customer to make use of the copyright software contained in the said software, which is purchased off the shelf or imported as shrink wrapped software and the same would amount to transfer of part of the copyright and transfer of right to use the copyright for internal business as per the terms and conditions of the agreement. Therefore, the contention of the assessee that there is no transfer of copyright or any part thereof under the agreements entered into by it with the non-resident supplier of software cannot be accepted. [Para 20]

It is well-settled that the intent of the Legislature in imposing sales tax and income-tax are entirely different as income tax is a direct tax and sales tax is an indirect tax and, wherefore, mere finding that the computer software would be included within the term 'sales tax" would not preclude the Court from holding that the said payments made by the assessee to the non-resident company in the instant case would amount to 'royalty' unless the assessee is able to prove that the said payment is for the sale of computer software, wherein the income would be from the business and in the absence of any permanent establishment of the non-resident supplier, there is no obligation on the part of the payee to make deduction under section 195(1). [Para 22]

It is well-settled that in the absence of any definition of 'copyright' in the Income-tax Act or the DTAA with the respective Countries, in view of clause 3 of the DTAA, reference is to be made to the respective law regarding definition of 'Copyright', namely, Copyright Act, 1957, in India, wherein it is clearly stated that 'literary work' includes computer programmes, tables and compilations including computer [databases]. [Para 23]

It is clear from the provisions of the Copyright Act that the right to copyright work would also constitute exclusive right of the copyright holder and any violation of the said right would amount to infringement under section 51 of the said Act. However, if such copying of computer programme is done by a lawful possessor of a copy of such computer programme, the same would not constitute infringement of copyright and wherefore, but for the licence granted in these cases to the assessee to make copy of the software contained in shrink-wrapped/off-the-shelf software into the hard disk of the designated computer and to take a copy for back-up purposes, the end user has no other right and the said taking back-up would have constituted an infringement, but for the licence. Therefore, licence is granted for taking copy of the software and to store it in the hard disk and to take a back-up copy and right to make a copy itself is a part of the copyright. Therefore, when licence is granted to make use of the software by making copy of the same and to store it in the hard disk of the designated computer and to take back-up copy of the software, it is clear that what is transferred is right to use the software, an exclusive right, which the owner of the copyright, i.e., the supplier owns and what is transferred is only right to use copy of the software for the internal business as per the terms and conditions of the agreement. [Para 24]

Therefore, the contention of the assessee that there is no transfer of any part of copyright or copyright under the impugned agreements or licenses cannot be accepted. Accordingly, right to make a copy of the software and use it for internal business by making copy of the same and storing the same in the hard disk of the designated computer and taking back-up copy would itself amount to copyright work under section 14(1) of the said Act and licence is granted to use the software by making copies, which work, but for the licence granted would have constituted infringement of copyright and licencee is in possession of the legal copy of the software under the licence. Therefore, the contention of the assessee, that there is no transfer of any part of copyright or copyright and transaction only involves sale of copy of the copyright software, cannot be accepted. What is supplied is the copy of the software of which the supplier continues to be the owner of the copyright and what is granted under the licence is only right to copy the software as per the terms of the agreement, which, but for the licence would amount to infringement of copyright and in view of the licence granted, the same would not amount to infringement under section 52 of the Copyright Act. Therefore, the amount paid to the non-resident supplier towards supply of shrink-wrapped software, or off-the-shelf software is not the price of the C.D. alone nor software alone nor the price of licence granted. This is a combination of all and, in substance, unless licence is granted permitting the end user to copy and download the software, the dumb C.D. containing the software would not in any way be helpful to the end user as software would become operative only if it is downloaded to the hardware of the designated computer as per the terms and conditions of the agreement and that makes the difference between the computer software and copyright in respect of books or pre-recorded music software as book and pre-recorded music C.D. can be used once they are purchased, but so far as software stored in dumb C.D. is concerned, the transfer of dumb C.D., by itself, would not confer any right upon the end user and the purpose of the C.D. is only to enable the end user to take a copy of the software and to store it in the hard disk of the designated computer if licence is granted in that behalf and in the absence of licence, the same would amount to infringement of copyright, which is exclusively owned by non-resident suppliers, who would continue to be the proprietor of copyright. Therefore, there is no similarity between the transaction of purchase of the book or pre-recorded music C.D. or the C.D. containing software and in view of the same, the Legislature, in its wisdom, has treated the literary work like books and other articles separately from 'computer' software within the meaning of the 'Copyright' as referred to above under section 14 of the Copyright Act. [Para 24]

> It 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 non-resident 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. In view of the said finding, it is clear that there is obligation on the part of the assessee to deduct tax at source under section 195 and consequences would follow. On facts and circumstances of the case, the Tribunal was not justified in holding that the amount(s) paid by the assessee to the foreign software suppliers was not 'royalty' and that the same did not give rise to any 'income' taxable in India and, wherefore, the assessee was not liable to deduct any tax at source. [Para 25]".

5. Similar issue for AY 2011-12 in the case of Nice Ltd. came up before the Hon'ble High Court of Karnataka in ITA No.7/2019 and vide judgment dated 26.3.2021 it was held as under:-

> "7. The controversy involved in the present case, as informed by the learned Counsel for the parties stands concluded on account of the judgment delivered by the Hon'ble Supreme Court in the case of ENGINEERING ANALYSIS CENTRE FOR EXCELLENCE PRIVATE LIMITED VS COMMISSIONER OF INCOME TAX & ANOTHER – AIR 2021 SC 124 / 432 ITR 471 (SC). The Apex Court in the aforesaid case has held in paragraphs 27, 47, 52, 168 & 169 as under:

"27. The machinery provision contained in Section 195 of the Income Tax Act is inextricably linked with the charging provision contained in Section 9 read with Section 4 of the Income Tax Act, as a result of which, a person resident in India, responsible for paying a sum of money, "chargeable under the provisions of [the] Act", to a non-resident, shall at the time of credit of such amount to the account of the payee in any mode, deduct tax at source at the rate in force which, under Section 2(37A)(iii) of the Income Tax Act, is the rate in force prescribed by the DTAA. Importantly, such deduction is only to be made if the non-resident is liable to pay tax under the charging provision contained in Section 9 read with Section 4 of the Income Tax Act, read with the DTAA. Thus, it is only when the non-resident is liable to pay income tax in India on income deemed to arise in India and no deduction of TDS is made under Section 195(1) of the Income Tax Act, or such person has, after applying Section 195(2) of the Income Tax Act, not deducted such proportion of tax as is required, that the consequences of a failure to deduct and pay, reflected in Section 201 of the Income Tax Act, follow, by virtue of which the resident-payee is deemed an "assessee in default", and thus, is made liable to pay tax, interest and penalty thereon. This position is also made amply clear by the referral order in the concerned appeals from the High Court of Karnataka, namely, the judgment of this Court in GE Technology (supra).

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 referred 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 characterized as royalty for the exclusive right to reproduce the book in the territory mentioned by the licence.

52. There can be no doubt as to the real nature of the transactions in the appeals before us. 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 in fact the sale of a physical object which contains an embedded computer programme, and is therefore, a sale of goods, which, as has been correctly pointed out by the learned counsel for the assessees, is the law declared by this Court in the context of a sales tax statute in Tata Consultancy Services v. State of A.P., 2005(1) SCC 308 (see paragraph 27).

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 S.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 (S. 9(1)(vi), along with explanations 2 and 4 thereof), which deal with royalty, not being more beneficial to the assessees, 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 manufacture/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.

> 8. In the light of the aforesaid judgment delivered by the Hon'ble Supreme Court, the question of law framed in the present appeal is decided in favour of the assessee and against the revenue."

6. Further, the judgment relied on by the DRP in the case of *Samsung Electronics (supra)* was reversed by the Hon'ble Supreme Court in Civil Appeal No.8733-8734/2018 & Ors. in the case of *Engineering Analysis Centre for Excellence Private Limited v. CIT & Anr. (supra)* which has been extracted in the foregoing paragraph. Being so, the issue before us is already settled by the Hon'ble Supreme Court in favour of assessee.

7. Further the ancillary support services are also to be considered as relating to software services.

8. Since we have allowed ground Nos.1 to 10, the other grounds do not require any adjudication.

9. In the result, the assessee's appeal is allowed.

Pronounced in the open court on this 05th day of July, 2021.

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

Bangalore,
Dated, the 05th July, 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.