Microsoft Corporation vs Director Of Income Tax on 18 July, 2022

Author: Manmohan

Bench: Manmohan, Manmeet Pritam Singh Arora

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* IN THE HIGH COURT OF DELHI AT NEW DELHI
+ ITA 663/2011
MICROSOFT CORPORATION
Through: Mr.Nageswar Rao w
Uppal and Ms.Deep
Advocates.
versus

DIRECTOR OF INCOME TAX
Through: Mr.Kunal Sharma,
counsel with Ms.Z
Mr.Shray Nargotra

CORAM:
HON'BLE MR. JUSTICE MANMOHAN
HON'BLE MS. JUSTICE MANMEET PRITAM SINGH ARORA
ORDER

% 18.07.2022 Present appeal had been admitted on the following substantial questions of law:-

> (i) Whether the Tribunal was right on facts and in law in holding that the income earned by the Appellant from distributing of computer software in India was royalty for the purposes of Section 9(1)(vi) of the Act?
>
> (ii) Whether the Tribunal was right in facts and in law in holding that the income earned by the Appellant was taxable as royalty under Article 12 of the Double Taxation Avoidance Agreement between India and the United States of America?
>
> (iii) Whether the Tribunal was right in facts and in law in holding that interest under Section 234B was chargeable?

In the opinion of this Court, the aforesaid issues are no longer res integra as the Supreme Court in Engineering Analysis Centre of Excellence Private Limited vs. Commissioner of Income Tax and Anr., (2021) SCCOnLine SC 159 has held as under:-

> "...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 an end-user, resident in India, from a foreign, non-resident supplier or manufacturer.
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> 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.
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> 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.
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> 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. These cases have a chequered history. The facts of C.A. Nos.8733-8734/2018 shall be taken as a sample, indicative of the points of law that arise from the various appeals before us. In this case, the appellant, Engineering Analysis Centre of Excellance Pvt. Ltd. ['EAC"], is a resident Indian end-user of shrink- wrapped computer software, directly imported from the United States of America ["USA"]. The assessment years that we are concerned with are 2001-2002 and 2002-2003.

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97. The AAR then reasoned that the fact that a licence had been granted would be sufficient to conclude that there was a transfer of copyright, and that there was no justification for the use of the doctrine of noscitur a sociis to confine the transfer by way of a licence to only include a licence which transferred rights in respect of copyright, by referring to explanation 2 to section 9(1)(vi) of the Income Tax Act. It then held:

> "Considerable arguments are raised on the so-called distinction between a copyright and copyrighted articles. What is a copyrighted article? It is nothing but an article which incorporates the copyright of the owner, the assignee, the exclusive licensee or the licencee. So, when a copyrighted article is permitted or licensed to be used for a fee, the permission involves not only the physical or electronic manifestation of a programme, but also the use of or the right to use the copyright embedded therein. That apart, the Copyright Act or the Income-tax Act or the DTAC does not use the expression 'copyrighted article', which could have been used if the intention was as claimed by the applicant. In the circumstances, the distinction sought to be made appears to be illusory."

98. This ruling of the AAR flies in the face of certain principles. When, under a non-exclusive licence, an end-user gets the right to use computer software in the form of a CD, the end-user only receives a right to use the software and nothing more. The end- user does not get any of the rights

that the owner continues to retain under section 14(b) of the Copyright Act read with sub- section (a)(i)-(vii) thereof. Thus, the conclusion that when computer software is licensed for use under an EULA, what is also licensed is the right to use the copyright embedded therein, is wholly incorrect. The licence for the use of a product under an EULA cannot be construed as the licence spoken of in section 30 of the Copyright Act, as such EULA only imposes restrictive conditions upon the end-user and does not part with any interest relatable to any rights mentioned in sections 14(a) and 14(b) of the Copyright Act.

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101. Also, any ruling on the more expansive language contained in the explanations to section 9(1)(vi) of the Income Tax Act would have to be ignored if it is wider and less beneficial to the assessee than the definition contained in the DTAA, as per section 90(2) of the Income Tax Act read with explanation 4 thereof, and Article 3(2) of the DTAA. Further, the expression "copyright" has to be understood in the context of the statute which deals with it, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA. For all these reasons, the determination of the AAR in Citrix Systems (AAR) (supra) does not state the law correctly and is thus set aside.

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173. 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.

174. 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."

Accordingly, the present appeal is allowed in terms of the judgment of the Supreme Court in Engineering Analysis Centre of Excellence Private Limited (supra).

At this stage, learned counsel for the appellant states that other connected appeals should also be heard expeditiously. In view thereof, Registry is directed to list ITA Nos.662/2011, 660/2011, 658/2011, 659/2011, 661/2011, 657/2011, 664/2011, 665/2011 & 667/2011 as well as the connected Cross Objections Nos.18359/2011, 18356/2011 & 18354/2011 on 29th July, 2022.

MANMOHAN, J MANMEET PRITAM SINGH ARORA, J JULY 18, 2022 KA