

# **Sonata Information Technology Ltd. vs Additional Commissioner Of ... on 31 January, 2006**

**Equivalent citations: [2006]103ITD324(BANG), (2007)106TTJ(BANG)797**

ORDER

Deepak R. Shah, Accountant Member

1. All the appeals by assessee are directed against various orders of learned Commissioner of Income-tax (Appeals)-IV, Bangalore dated, 18-3-2004, 23-3-2004, 31-3-2004, 29-6-2004 and 23-9-2004 in the appeals filed under Section 248 of the Income-tax Act, 1961 ('the Act'). The assessee filed the appeals under Section 248 denying his liability to deduct tax under Section 195 in respect of payment made for purchase of software from various concerns abroad.

2. Since the appeals before learned CIT(A) were filed under Section 248 of the Act, there is no finding of the Assessing Officer available on the issue. However, the Assessing Officer on earlier occasion has held that the assessee as the 'assessee in default' under Section 201 for failure to deduct tax on similar payments. Learned CIT(A) by order dated 27-2-2004 has confirmed the action of Assessing Officer. The assessee challenged the order of learned CIT(A) dated 27-2-2004 before this Tribunal. The Tribunal by its order in ITA Nos. 864 & 865/Bang./2004, dated 28-4-2005 following the decision of Income-tax Appellate Tribunal in the case of Samsung Electronics Co. Ltd. v. ITO in ITA Nos. 264 to 266 dated 18-2-2005, [2005] 94 ITD 91 (Bang.) held that the amount paid by assessee is for purchase of goods and not towards payment of royalties. The payment is for use of copyrighted article and not to acquire any copyrights in such articles. Thus the payment was not treated as payment for royalty within the meaning of Explanation 2 to Section 9(1)(vi) of the Act. It was held that since the payee has no permanent establishment in India, the business profit in such transaction cannot be deemed to be accruing or arising in India. The assessee was, therefore, held not in default under Section 201 of the Act. Since the learned CIT(A) did not have the benefit of the order of this Tribunal, he has followed his earlier' order holding that the assessee is liable to deduct tax under Section 195 of the Act. Therefore the assessee is in appeal before us.

3. Learned Counsel for assessee Sri Arvind Sonde submitted that the assessee is carrying on business of trading in software packages commonly known as 'shrink wrapped software packages' or canned software. The assessee has entered into several agreements in the course of its activity for the purpose of distributing these software packages to its customers. For the appeals under consideration, the assessee imported shrink wrapped software from the following parties:

1. Actuate Corporation, USA
2. Borland Australia Ply Ltd.
3. Business Objects.

4. Citrix, Australia
5. Computer Associates International Inc.
6. Corel Pty Ltd.
7. Crystal Decisions Singapore Pte Ltd.
8. Datadirect Technologies Ltd.
9. Interact Commerce, Australia
10. Iona Technologies.
11. Macromedia Inc., USA
12. Macromedia, Netherlands.
13. Microsoft Regional Sales Corporation, Singapore
14. Redpriarie.
15. SCO Operations Inc. (Formerly Caldera)
16. Trend Micro Inc., Taiwan.

The imports were made as per terms of agreement (in most cases) entered into with these non-residents.

3.1 Explaining the meaning of the term 'shrink wrapped software or canned software', Shri Sonde submitted that 'Canned software' means a generalised software, not specifically created for a particular consumer. The shrink wrapped software is of the ownership of the companies/persons, who have developed that software. The assessee is a licensee with permission to sub-license these packages to others. The canned software packages are like Microsoft, Lotus, Oracle etc. The assessee in the course of its business activity acts as a distributor. As a standard feature comprising of distributor duties, the assessee is refrained from making any copy of the product imported without the prior consent of the seller (foreign party). The assessee had sold the software bought in fully packed condition as received from the overseas vendor to various customers in India without opening the package. The assessee acquires during the course of business a copyrighted article whereas the copyright remains with the owner or the seller. What the assessee acquires is the material object available off the shelf which is different from copyright. The assessee has mainly obtained the right to distribute the copyrighted material, which is different from ownership of the copyright in the software. The assessee considered the incomes represented by these payments to be "business profits" of the non-resident taxable only under Article 7 of respective Double Taxation

Avoidance Agreements (DTAA), if there was a permanent establishment in India of the non-residents in India. In the absence of a P.E., the assessee considered the payments as not chargeable to tax in India and therefore outside the purview of tax deduction under Section 195. According to the Assessing Officer the payments are covered by definition of 'Royalty' under Section 9(1)(vi) of the Act and therefore Section 195 applies in this case. The Assessing Officer thus held these payments, fall within the purview of Section 9(1)(vi) of the Act, since the import of software packages does not constitute goods. Accordingly tax on royalty under Section 195 of the Act had to be deducted at the rates specified in the Act or in DTAA. The Assessing Officer followed his orders under Section 201(1) of the Act dated 31-1-2003 and applied the same logic to the impugned appeals in arriving at this conclusion.

3.2 Shri Sonde relied upon the order of Income-tax Appellate Tribunal in assessee's own case vide its order dated 28-4-2005, wherein it is held as under:

The payment is for use of copyrights article and not for acquiring any copyright. This view has been arrived at after considering various decisions on the subject as well as the decision of Hon'ble Supreme Court in Tata Consultancy Services case (supra). We accordingly hold that the payments for import of software do not amount to payment of royalty chargeable under Section 9(1)(vi) of the Act. The payments partakes the character of purchase and sale of goods. Actually, the payee has no permanent establishment in India. Hence it can be concluded that no income is deemed to accrue or arise in India. Accordingly the provision of Section 195 is not applicable to such payment.

He accordingly submitted that the transactions being of similar nature, the earlier order of the Hon'ble Bangalore Tribunal covers the issue under consideration. It is therefore submitted that the provisions of the Section 195 of the Act are not applicable to such payments.

4. Learned D.R. Sri Ajit Korde at the outset mentioned that, the ITAT, Bangalore has already decided the issue of law involved in this appeal in the case of the same assessee-company vide 28-4-2005 (ITA 864 and 865 & 3132 and 3133/B/04) and in the case of Hewlett-Packard (India)(P.) Ltd. [IT Appeal Nos. 3707 to 3710/(B) of 2004 dated 27-9-2004]. The ITAT has followed its order in case of 'HP in the cases of EDS Technologies Pvt. Ltd. and in the case of "Line Software Services Pvt. Ltd." However, he further submitted that on perusal of the ITAT's order in the case of 'Hewlett-Packard (India)(P.) Ltd.' show that the ITAT has not considered the material placed before it in the Department's Paper Book and arguments advanced by the written submission. Similarly, Tribunal has not given finding on the part of the judgment of the CIT(A), in which CIT(A) has held that, software is also 'Invention' or 'Secret Formula' or 'Process' or 'Scientific Work' or 'Patent'. He thereafter submitted that as per the decisions given by the High Courts and Supreme Court, 'the Tribunal is under the obligation to give findings on the arguments advanced by the parties' as held in -

a. CIT v. G.M. Mittal Stainless Steel Ltd.

b. Udhavdas Kewalram v. CIT c. E.A. Venkataramier and Sons v. CIT [1967] 65 ITR 316 (Mad.) d. CIT v. Hyderabad Secunderabad Foodgrains Association Ltd.

e. A. Venkata Rao v. CIT In view of the above position of law, Sri Korde requested that, the Bench may kindly give findings on the submission made, by the Department. In the cases of Samsung Electronics Co. Ltd. (supra) and Motorla Inc. v. Dy. CIT [2005] 95 ITD 269 (Delhi)(SB) : 147 Taxman 39(Mag.) have decided the case in which assessee-companies had imported software for their own use. In those cases, the Tribunal has laid down that payment for copy of software made by the Indian company to the foreign company was for the copyrighted article and was not for use of copyright. Therefore, such payment cannot be considered as a 'royalty' either under the Income-tax Act or the DTAA. In the above decisions, the Tribunal has not decided question of TDS on payment made by the Indian company to foreign company for imported software meant for sale to customers in India. In the present appeals before the Tribunal, such is the matter of dispute.

4.1 Shri Korde further submitted that, all the DTAA's define 'royalty' more or less as under:

Payments of any kind received as consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof.

Therefore, first question to be considered is : 'whether imported software sold by the Indian companies amount to sue of copyright of the foreign company or not? The term 'Copyright' is not defined in the DTAA. Hence for income arising and accruing in India and for determining use of copyright, provisions of Indian Copyright Act, 1957 will have to be considered. Recently inserted Section 90(3) of the Income-tax Act also provides for the same. According to Section 14 of the Indian Copyright Act, 1957, right to sell is an exclusive right of the owner. Indian Companies without entering into agreement with the foreign company cannot sell the copies of the software to the Indian customers. Hence, Indian Companies use copyright of the owner of the computer software of right to sell.

Learned D.R. submitted that as per Section 14(b)(ii) of the Copyright Act, 1957 right to sell is an exclusive right of the owner of a copyright. As per Section 51(b)(i) and (ii) of the Copyright Act, unauthorized sale or distribution of the copy infringes owners copyright. As per the commentary of Article 12 of OECD model of tax convention, payment for acquisition of partial rights in copyright is royalty, but payment for full ownership of copyright is either capital gain or commercial income. As per the intellectual property right law, Indian Copyright Act prohibits sale or hire of computer software. As per Section 106A of US Copyright Act, unauthorised sale or distribution of computer software is prohibited. Similarly under Section 23 of

Designs and Patents Act, 1988 of U.K., unauthorised sale or distribution of computer software is prohibited. Hon'ble Delhi High Court in the case of Penguin Books Ltd. v. India Book Distributors held that sale of imported copies of book by an Indian Distributor without license to do so infringes UK publishers copyright. The Special Bench of Income-tax Appellate Tribunal, Delhi in the case of Motorola Inc. (supra) held that right to sale and distribute computer software is available only to the owner of the computer software. Since the assessee has distributed the software, the assessee or the ultimate payee can be said to have acquired the copyright or right to use the copyright and hence to be treated as payment for royalty within the meaning of Explanation 2 to Section 9(1)(vi) of the Act.

4.2 Alternatively, lump sum payment is to be apportioned towards taxable portion as royalty and non-taxable portion as cost of goods as royalty payment is embedded in total consideration of software. Difficulty in apportionment cannot be a ground for non-apportionment as held in cases of Transmission Corporation of AP Ltd. v. CIT and CIT v. Best and Co. (P.) Ltd. .

4.3 Shri Korde further submitted that second question to be considered is: whether the payment is made for using 'Invention' or 'Secret Formula' or 'Process' or 'Scientific Work' or 'Patent'? 'Royalty' as per Section 9(1)(vi) of the Income-tax Act means, inter alia:

(a) there has to be a consideration

(b) the consideration should be for transfer of all or any rights (including the granting of license) in respect of a:

(i) Copyright

(ii) Patent

(iii) Invention

(iv) Design

(v) Secret formula or process

(vi) Scientific work Accordingly, the point of consideration should be whether the consideration is for the use of or the right to use any of the category of the properties mentioned in Royalty definition. The contention that if software is covered by one of the terms mentioned in the meaning of royalty, it cannot be covered by other items does not have merit, since the definition covers consideration in respect of different attributes of mainly intellectual properties some of which are overlapping as well. Thus, a computer programme itself may have copyright, patent as well as trademark

associated with it and in case of consideration for all the three terms used will be attracted.

An example of overlapping categories is copyright of a literary or scientific work. A literary work is copyrightable but a scientific work can also be in literary form and therefore copyrightable. It may therefore fit in the category of both literary and scientific work. Some of the intellectual properties are present in the definition both in the form of protected rights and unprotected rights. Thus a copyrighted secret formula may enjoy protection under Copyright Act, if expressed in a literary medium or a patented process may also be protected under Patent Act but even if they are not protected by intellectual property rights legislations, they will nevertheless be covered by the term 'secret formula' or 'process' if the consideration is for use of such a property. The fact that computer programme fits into more than one category is recognized in IRS Regulations also when it is considered under categories of copyright as well as know-how.

Consideration paid for the use of a patented article would fall within the definition of Royalty payment. Since one of the rights of the patent holder is the right to use the invention (apart from the right to make or vend), which he can license to others. Softwares are entitled to Patents which is evidenced from thousands of Softwares have been patented all over the world. Patent gives an exclusive right to inventor to use make and/or vend his patented article. In Patent Law, the Patentee gets, inter alia, an exclusive right to sue the article (on which he has the Patent). This exclusive right (to use) can be transferred to others either by selling the product (where an ownership is transferred) or through a license agreement, allowing the license to use the article for a consideration. Hence, it is absolutely correct to say that payment made for the use of patented article is for the use of patent since physical use of the article (which is patented) is a right vested to patentee by Patent Law. In respect of Software, which is patented, the same can be licensed for physical use. And as discussed earlier, the right to physically use the article (which is patented) is one of the rights embedded in the Patent Rights. The common argument that it is only the source code that is entitled to Patent and not the object code, is without any merits. It is the technology that gets patented. For software, technology is the logic behind the programme. This logic when written in 'man-readable' form is known as the "source-code" and when the same is converted into machine readable form, it is called the "object-code", however, during the translation, the logic remains intact. There appears to be some confusion in respect of the term "use of" in relation to a property which would become clear when one examines the basic definition of royalty as stated in *Corpus Juris Secundum* which was quoted with approval by the Hon'ble Gujarat High Court in the case of *CIT v. Ahmedabad Mfg. Calico Printing Co.* [1983] 139 ITR 806 as:

Defined generally, the word 'royalty' means a share of the product or profit reserved by the owner for permitting another to use the property; the share of the production or profit it paid to the owner; a share of the product or proceeds therefrom reserved to the owner for permitting another to use the property; the share of the produce reserved to the owner for permitting another to exploit and use the property; a share of the profit, reserved by the owner for permitting another to use the property; the amount reserved or the rental to be paid the original owner of the whole estate.

An asset would be said to be exploited only when it is replicated or distributed or sold. The Hon'ble Gujarat High Court in the case of CIT v. New India Industries Ltd. , after considering many decisions of the Hon'ble Supreme Court and other High Courts had observed that-

So long as the commercial asset is capable of being exploited as such, income is business income.... He is entitled to exploit it to his best advantage and he may do so either by using it himself personally or by letting it out.

Accordingly, physical use of an asset is also an integral form of exploitation. In case of softwares, these are exploited by using them to further develop application softwares.

4.4 The software is also an invention by the person who has copyright of same. 'Invention' means innovative article or an innovative process. Even if it is not patented, a software programme of this kind is a high technology work, and is essentially an "invention" (to "invent" means create by thought, devise, originate a new method, an instrument, etc.... and "inventions" means the process of inventing, a thing invented). These softwares are not routine, run-of the mill kind of programmes but are highly sophisticated and complex, which require investments in millions of dollar and hundreds of man-hours for development. An inventor's property rights in the invention may be transferred by granting a license to use his invention on Royalty. "Consideration paid for the use of invention" - The expression used in the definition of 'Royalty' means consideration paid inter alia, for the physical use of an innovative article or an innovative process. Since a patent as per Patent Law can be given only to an invention, and the very fact that tens of thousands of softwares have been patented, it can only mean, that there is no stretching and over stating the meaning of the word "invention" when applied in the context of "software". When a person pays thousands of dollars for acquiring the license to use software, he does not make payments of such amounts for simple run-of the mill programmes which do some simple arithmetic calculations. Instead, these softwares represent innovative ways of doing complex things in a simpler and systematic manner and also doing things which would not have been possible without the use of softwares as they embody new and innovative technology. For e.g., the most readily and commonly available programme Windows - is an operating system; which makes the hardware of PCs work. Thus, such kinds of softwares are rightly labelled as "Invention".

4.5 As argued by Shri Korde, these softwares can also be considered as "scientific work" (the word 'scientific' means systematic, accurate, assisted by expert knowledge) because software is essentially a systematic array of logical instructions which is developed by persons who are experts in that field, Consideration for the use of scientific work has also been covered in the definition of Royalty. The term used in the said definition are "the transfer" of all or any rights (including the granting of a license) in respect of... any scientific work". Accordingly, transfer of any right in respect of any scientific work would also include license to sue. When a software

engineering firm uses the software to develop an application software or to do some data processing, it is exploiting the software.

4.6 Shri Korde alternatively argued that, these softwares can also be classified as secret formula or process. The software programme as mentioned above is an array/sequence of instructions, which are used by the computer, or computer aided equipment to do a certain thing by carrying out procedures in a systematic manner. This is what a formula does. Since the source code of this software programme is not made public, it is secret. Similarly the software can also be termed as a "process". The word "process" has been defined in the Oxford Dictionary as "course of action or a procedure, especially a series of stages in manufacture or some other operation". As per Corpus Juris Secundum, the meaning of the term 'Process' as understood in Patent Laws is:

- a mode, method or operation whereby a result or effect is produced.
- A means devised for the production of a given result.
- An operation done by rule in order to secure a result.

This is exactly how a software works in a series of instructions/operations to achieve a desired result. It would suffice to say here that software can rightly be termed as "formula". And since the source code is not given, to the user the formula (in form of the logic of the software) actually remain secret since the user is unable to decipher the object code. It may also be mentioned here that Canada (which is a part of OECD) has not accepted the OECD Model Convention in respect of tax treatment of software purchases. In Canada payments by use of software are payments for the use of secret formula or process and thus are royalties. Similarly, countries like Spain, Greece, Portugal (who are part of OECD) have reserved the rights to tax the software income as royalties. It may also be mentioned here that many companies in India (including some MNCs) have been regularly deducting tax on their own on such remittances treating them as royalty payments.

4.7 Shri Korde ultimately submitted that what is taxed as royalties is the amount received as consideration for the use or the right to use, and not outright purchase of the right to use, an asset. Royalty is thus a consideration, including a lump sum consideration, for the transfer of all or any right (including the granting of all license) in respect of a copyright, patent, trademark, design and model, or secret formula, etc. transfer of the "right in the property" is not the subject-matter. It is the transfer of the "right in respect of the property". The two transfers are distinct and have different legal effects. In one, rights are purchased (which enables use of those rights), while in the other, no purchase is involved, only the right to use has been granted. Ownership denotes the relationship between a person and an object forming the subject-matter of his ownership. It consists of a complex of rights, all of which are rights in rem,



being good against all the world and not merely against a specific person and such rights are indeterminate in duration and residuary in character *Swadesh Ranjan Sinha v. Haradeb Banerjee and Sukumari Debi v. Ramdas Ganguli* . When rights in respect of a property are transferred and not rights in the property, there is no transfer of the rights in which may be good against the world but not against the transferor. In that case the transferee does not have the rights which are indeterminate in duration in residuary in character. Lump sum consideration is not decisive of the matter, That summary be agreed for the transfer of one right, two rights and so on but not the ownership. Thus, the definition in respect of the copyright, patent etc. does not extend to the outright purchase of the right to use an asset. A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and therefore, not royalty : *D.B. Group Ltd. v. CIT, DGB Production Ltd. v. CIR* [1996] 17 NZTC 12446. In an outright transfer to be treated as sale of property as opposed to license, alienation of all right in the property is necessary indeterminate in duration in residuary in character. Lump sum consideration is not decisive of the matter. That summary be agreed for the transfer of one right, two rights and so on but not the ownership. Thus, the definition in respect of the copyright, patent etc. does not extend to the outright purchase of the right to use an asset. A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and therefore, not royalty : *D.B. Group Ltd. v. CIT, DGB Production Ltd.*'s case (supra). In an outright transfer to be treated as sale of property as opposed to license, alienation of all right in the property is necessary.

The said distinction has been recognized and given effect to in the following judicial pronouncements:

Hon'ble Calcutta High Court in the case of *CIT v. Davy Ashmore India Ltd.* held thus:

The term 'royalty' has been defined in the agreement to mean, inter alia, the payment of any kind including rentals received as a consideration for the use of or the right to use any patent, trademark, design or model, plan, secret formula or process. It is important that in order that a payment may be treated as royalty for the purposes of Article XIII of the Agreement for Avoidance of Double Taxation between India and the U.K., the person who is the owner of such patents, designs or models, plans, secret formula or process, etc. retains the property in them and permits the use or allows the right to use such patents, designs or models, plans, secret formula, etc. In other words, where the transferor retains the property right in the designs, secret formula, etc., and allows the use of such right, the consideration received for such user is in the nature of royalty. Where, however, there is an outright sale or purchase, the consideration is for the transfer of such designs, secret formula, etc., and cannot be treated as royalty.

Hon'ble Gujarat High Court in the case of Ahmedabad Mfg. & Calico Printing Co. (supra) held thus:

In the case of secret process, patents, special inventions, when right of exploitation is given by the owner of the inventions, patents etc., to a third party instead of outright sale, then for the right to exploit these inventions, secret processes, some amount may be paid and the amount paid may be correlated to the extent of exploitation. It is in this sense that license agreements for the exploitation of patents, inventions, etc. are being entered into in modern commercial world and as part of such agreements, even knowledge derived from his own experience and technical know-how for the most economical and efficient user of the patents, inventions, etc. are parted with by the licensor to the licensee. Payments of this kind are known as 'royalties'. This is also evident from several double taxation avoidance agreements between the Government of India and foreign countries such as Sweden, in which the royalty has been defined. That such payments are royalties is also evident from the definition of the word 'royalty' in Section 9(1)(vi), Explanation 2, which was subsequently introduced by the Finance Act, 1976, with effect from 1-6-1976.

In view of the above legal position, assessee's appeals may be dismissed.

5. In reply Sri Arvind Sonde submitted that the stand of learned CIT(A) is that the amount paid by appellant for the transfer of rights in respect of any copyright. This is clear from the written submission made before him and the issue dealt by learned CIT(A) is also that the payment is considered as for granting any licence in respect of any copyright and not for a patent, invention, model, design or secret formula. If the assessee is treated as 'assessee in default' for payment made in respect of software purchased as towards copyright and if it is not the case of either the Assessing Officer or learned CIT(A) that the payment is for anything else than a copyright, the alternate plea raised by learned D.R. should not be entertained. Computer software is always treated as protected under Copyright Act and not under Patents Act. This is clear from the definition of "Computer programme" given in Section 2(ffc) of the Copyright Act, 1957. At any rate there is no transfer of any right including granting of a licence in respect of such computer programme and hence cannot be considered as royalty within the meaning of Explanation 2 to Section 9(1)(vi) of the Act.

6. We have carefully considered the relevant facts, argument advanced and decisions cited. It is agreed by both the counsels that the issue is covered in ITA Nos. 864 & 868/Bang./04, dated 28-4-2005 in assessee's own case. However, since it is the contention of learned D.R. that the issue is to be examined whether the payment is covered as royalty whereunder Clause (i) or under Clause (v) of Explanation 2 to Section 9(1)(vi) of the Act, we shall deal with the same. It is also clear that no contrary decision has been cited before us. However, to rest the matter we shall deal with all the argument raised by learned D.R. The words "computer programme" is not defined except under the Copyright Act, 1957. As canvassed by learned Counsel for assessee the computer programme are not protected under the Patent Act. Clause (i) of Explanation 2 to Section 9(1)(vi) applies to transfer of all or any rights including the granting of a license in respect of patent, invention, model, design, secret formula or process or trademark. Clause (v) of Explanation 2 to Section 9(1)(vi) applies to

transfer of any rights including the grant of license in respect of any copyright, literary, artistic or scientific work. Thus it can be held that "Copyright" and "Patent, invention, model, design, and secret formula operate in different fields." When the computer programme is defined and protected under Copyright Act, it is incorrect to say that the computer programme can also be considered as "Patent invention, model, design, secret formula or process". At any rate there is no transfer of any rights including granting of license in respect of such property. The rights of various payments remain protected and cannot be considered to have been transferred or even a license is granted in respect of such rights. What the assessee or the ultimate buyer pays is for use of a copyrighted article and not receiving any right in the copyright.

6.1 Since the major part of imports is from Microsoft Regional Sales Corpn., the contents of the agreement is reproduced and discussed below:

An agreement was entered into between Microsoft Regional Sales Corporation and the appellant on 1-7-2003. This agreement provided for the appellant to be appointed as its Non-Exclusive Distributor in India for the distribution of Microsoft Corporation product. The Distributor's rights to distribute product under the agreement extended only to the territory defined in the agreement.

Clause 2 of the agreement provides for appointment, which reads as under:

2. Appointment. - Subject to the provisions of this Agreement MRS appoints the Distributor as its non-exclusive distributor of the Products in the Territory.

Clause 7 provides for the Distributor's Duties and the relevant Clauses 7(i) and 7(j) reads as under:

7. The distributor's duties 7.1 The distributor agrees to:

(a) to(h) \*\* \*\* \*

(i) If MRS so requests, the Distributor shall assist MRS or any affiliate of MRS in preventing, investigating and prosecuting any infringement of the Products by any person. The Distributor agrees to promptly inform MRS or, if directed by MRS, a specified affiliate of MRS (including Microsoft Corporation or MO).

(j) Refrain from making copies of any diskettes or documentation related to any Microsoft software product for any purpose without the prior written consent of MO, MRS or Microsoft Corporation.

Further Exhibit 1 to the agreement is regarding Product Ordering and Delivery Terms, Exhibit 2 Product Return Terms, Exhibit 3 General Provisions Applicable in Territory, Exhibit 4 Territory Specific Tax Provisions, Exhibit 5 - Notices, Exhibit 6 - Confidentiality Terms. Clause 4 of this Exhibit reads as under:

4. Miscellaneous:

(a) All Confidential Information and Confidential Materials are and shall remain the property of MRS. By disclosing information to Company, MRS does not grant any express or implied right to Company to or under Microsoft patents, copyrights, trademarks, or trade secret information.

(b) If MRS or any MRS affiliate provides pre-release PC operating system software ("Product") as Confidential Information or Confidential Materials under this Agreement:

(i) such Product is provided "as is" without warranty of any kind; and

(ii) Company agrees that neither MRS nor its suppliers shall be liable for any damages, injury or loss whether direct or indirect, and whether arising at law, by statute, in equity or otherwise arising from the relationship between the parties, relating to Company's use of such Product; and

(iii) this Agreement shall not extend beyond (a) the commercial release of the Product, (b) an earlier public disclosure of the Product authorized by MRS affiliate, or (c) one year from the date of disclosure of information covered by the NDA to a person subject to the NDA, whichever comes first.

(c) Company agrees that it does not intend nor will it, directly or indirectly, export or re-export (i) any Confidential Information or Confidential Materials or (ii) any product (or any part thereof), process, or service that is the direct product of the Confidential Information or Confidential Materials (A) to any country that is subject to U.S. export restrictions (currently including, but not necessarily limited to Iran, Iraq, Syria, Cuba, North Korea, Libya and Sudan), or to any national of any such country, whichever located, who intends to transmit or transport the products back to such country; (B) to any end-user who Company knows or has reason to know will utilize them in the design, development or production of nuclear, chemical or biological weapons; or (C) to any end-user who has been prohibited from participating in U.S. export transactions by any federal agency of the U.S. Government.

(d) This Agreement constitutes the entire agreement between the parties with respect to the subject-matter hereof and merges all prior discussions between them as Confidential Information. It shall not be modified except by a written agreement dated subsequent to the date of this Agreement and signed by both parties. None of the provisions of this Agreement shall be deemed to have been waived by any act or acquiescence on the part of MRS, its agents, or employees, but only by an instrument in writing signed by an authorized officer of MRS. No waiver of any provision of this Agreement shall constitute a waiver of any other provision(s) or of the same

provision on another occasion.

(e) If either MRS or company employs attorneys to enforce any rights arising out of or relating to this Agreement, the prevailing party shall be entitled to recover reasonable attorneys' fees. This Agreement shall be construed and controlled by the laws of Singapore, and company further consents to the jurisdiction of the courts sitting in Singapore. Process may be served on either party by postal service, postage pre-paid, certified or registered, or return receipt requested.

(f) Subject to the limitations set forth in this Agreement, this Agreement will inure to the benefit of and be binding upon the parties, their successors and assigns.

(g) If any provision of this Agreement shall be held by a court of competent jurisdiction to be illegal, invalid or unenforceable, the remaining provisions shall remain in full force and effect.

(h) All obligations created by this Agreement shall survive change or termination of the parties' business relationship.

A perusal of the above agreement indicates that in all the cases the copyright is retained with the owner and only the copyrighted article has been sold to the Distributor (the Appellant) for distribution in India.

6.2 At this juncture, it is made clear that all the impugned appeals are filed suo motu under Section 248 of the Income-tax Act. Thus, the appellant has been deducting tax at source and filing an appeal before Commissioner of Income-tax under protest. The main reason for arriving at such a conclusion is that the Assessing Officer was of the view in the past as per the order under Section 201(1) dated 31-1-2003 that the appellant ought to have deducted tax at source under Section 195 of the Income-tax Act on the ground that the payments made to these parties were payments made for the license to use a copyright. According to the Assessing Officer there was no sale of software as there was no transfer of ownership rights and sale, if any, was only restricted to the Carrier Media i.e., floppy or CDs in which the software is transacted. The Assessing Officer was of the view that the inclusion of an intermediary in the form of Distributor/Reseller would not change the inherent character of the transaction since the Reseller or Distributor did not get any right in the software. In other words the Reseller and Distributor were merely passthrough. According to the Assessing Officer even if one were to take the view that there was an alienation of any such right of property as the Reseller further alienated the software to the End User, it was tantamount to royalty. According to the Assessing Officer the various Vendors have authorised the Reseller i.e., Sonata Information Technology Ltd. (SITL) to sell or give on commercial rental any copy of the computer programme, thereby giving a right in the copyright as per Sub-clause (ii) of Clause (b) of Section 14 of the Copyright Act, 1957.

To buttress these findings the Assessing Officer had referred to certain rulings from the USA, Australia and Singapore taxation authorities. He has pointed out that the Singapore taxing authority

has specifically granted exemption from withholding tax for royalties pertaining to "shrink-wrap" software. According to the Assessing Officer this was indicative of the fact that payment for software was otherwise chargeable to royalty. He has then referred to a US IRS Ruling whereby software programmes were treated as copyrighted articles and payments for licensing of such copyrighted articles were held not to constitute royalty. According to the Assessing Officer this was only applicable to one attribute of software ie., copyright and other attributes like patent, invention, process etc. had not been considered at all. He was of the view that the US ruling therefore does not advance the case of the appellant. He has thereafter referred to the OECD commentary where the US has observed that where payments were made for software for the personal or business use and the purchaser is required to make payments by referring productivity or use of software, it may constitute royalty. Therefore, according to the Assessing Officer where the payment has been made for the use of software for a fixed period, it would constitute royalty.

He thereafter referred to software in the context of the ruling of an Australian Court which held that the amount received in respect of Computer software would not be royalty if it does not give any rights in the copyrights. He has however not followed that reasoning to the appellant without giving any reasons. He has thereafter dealt with the contention that the software constitutes goods. According to the Assessing Officer software does not constitute "goods". Accordingly he has directed that tax on royalty under Section 195 ought to be deducted at the rates specified in his order.

6.3 The question which arises is whether the payments made by the appellant for distribution of the software acquired from the Vendors can at all be considered to be the payment made in respect of 'Royalty' within the meaning of Explanation 2 to Section 9(1)(vi) of the Income-tax Act, 1961. The further question which arises is whether in respect of countries where India has entered into agreements for avoidance of double taxation, the payments fall within the scope of the term royalty under such DTAA. The Assessing Officer has held that the payments made by the appellant for the licence to use the software is liable for deduction of tax on the premise that the same is royalty.

Royalty is defined in Section 9(1)(vi) Explanation 2 to Section 9(1)(vi) of the Act as under:

Section 9(1)(vi)....

Explanation 2.-For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for-

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trademark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trademark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trademark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in Section 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or

(vi) the rendering of any services in connection with the activities referred to in Sub-clauses (i) to (v);

The term 'royalty' is defined under the various DTAA relating to the case of the assessee as under:

Singapore Article 12 - Royalties and fees for technical services.- 1. & 2.\* \* \*

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use:

(a) any copyright of a literary, artistic or scientific work, including cinematograph film or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information;

(b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8.

USA Article 12 - Royalties and fees for included services - 1. & 2.\* \* \*

3. The term "royalties" as used in this Article means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright or a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property

which are contingent on the productivity, use, or disposition thereof; and

(b) payments of any kind received as consideration for the use of or the right to use, any industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8.

UK Agreement for avoidance of double taxation and prevention of fiscal evasion with United Kingdom of Great Britain and Northern Ireland Article 13 - Royalties and fees for technical services-  
1. & 2. \* \* \*

3. For the purposes of this Article, the term "royalties" means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

AUSTRALIA Australia - Agreement for avoidance of double taxation and prevention of fiscal evasion with Australia.

Article XII - Royalties

1. & 2. \*\* \*\* \*\*

3. The term "royalties" in this Article means payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for:

(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right;

(b) the use of, or the right to use, any industrial, commercial or scientific equipment;

(c) the supply of scientific, technical, industrial or commercial knowledge or information;



(d) the rendering of any technical or consultancy services (including those of technical or other personnel) which are ancillary and subsidiary to the application or enjoyment of any such property or right as is mentioned in sub-paragraph (a), or any such equipment as is mentioned in sub-paragraph (b) or any such knowledge or information as is mentioned in sub-paragraph (c);

(e) the use of, or the right to use:

(i) motion picture films;

(ii) films or video tapes for use in connection with television; or

(iii) tapes for use in connection with radio broadcasting;

(f) total or partial forbearance in respect of the use or supply of any property or right referred to in sub-paragraphs (a) to (e); or

(g) the rendering of any services (including those of technical or other personnel), which make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or design; but the term does not include payments or credits relating to services mentioned in sub-paragraphs (d) and (g) that are made:

(h) for services that are ancillary and subsidiary, and inextricably and essentially linked, to a sale of property;

(i) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;

(j) for teaching in or by an educational institution;

(k) for services for the personal use of the individual or individuals making the payments or credits; or

(l) to an employee of the person making the payments or credits or to any individual or firm of individuals (other than a company) for professional services as defined in Article 14.

Broadly the aforesaid definitions cover the payments for the use or a right to use intellectual property rights specified therein or for certain specified categories of equipments. The assessee submits and rightly so that the payments made by it for the purchase of software are payments for the acquisition of software products and is not consideration for acquisition of any intellectual property rights specified in the aforesaid definitions of the term 'royalty' for the reasons mentioned

below.

6.4 For ascertaining whether the payment under consideration falls within the scope of royalty under the Act or under the DTAA the reason given by the Assessing Officer is that the payment made by appellant is for the transfer of all or any rights in copyright. Before this question is dealt with, it is necessary to understand exactly what is software.

Section 2(ffc) of the Copyright Act, 1957 defines 'computer programme' as under:

(ffc) "computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result.

In Copyright and Industrial Designs - Third Edition, P. Narayanan at page 44, the learned Author describes 'computer software' as under:

3.62 Computer software. - Computer software includes many items like the programme manuals and papers, punched cards and magnetic tapes or discs required for the understanding or operation of computers. Computer programmes are not considered capable of protection under Patent Law. Manuals and papers included in computer software may be considered as literary works. Similarly computer printouts can be considered as literary work. The concept or idea of algorithms, frequently used in computer programming is not capable of copyright protection. Punched cards contain certain information in a particular notation. They may, therefore, be considered as literary work. Magnetic tapes and discs including floppy disc contain information recorded by means of electronic impulses. It may perhaps be considered as literary work if electronic impulses recorded in it could be considered as a form of writing in notation. There is, however, no authority on this point. Programmes devised for the working of computers, is generally regarded as coming within the definition of literary and artistic works.

[Emphasis supplied].

Computer - "Computer" includes any electronic or similar device having information processing capabilities. See Section 2(ffb).

No exhaustive definition of a computer is possible or available because the type of computer functions, capacities and technology involved is rapidly changing.

A simple definition is "A device that receives, processes and presents information" (See McGraw Hill Concise Encyclopaedia of Science and Technology). There are two basic types of computers; namely, analog and digital. For the purposes of the Copyright Law the distinction between the two types is not material. Copyright Law is interested in the computer software and not in the computer itself.

3.63 Computer programme. - Computer programme has been held to be 'literary work' written down, recorded or otherwise reduced to material form. Copyright subsists in a computer programme provided sufficient effort or skill has been expended to give it a new and original character. However, a computer programme which does no more than produce the multiplication tables, or the alphabet, cannot lay claim to copyright protection. That is because the amount of skill or effort entailed in such an exercise is too trivial to render the resultant work something which is new and of original character.

3.64 Statutory definition of computer programme.-"Computer Programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result, Section 2(ffc).

The definition is probably adopted from the definition given by World Intellectual Property Organisation, Draft Model Provision for Legislation in the field of Copyright, October 1988 as follows:

A computer programme is a set of instructions expressed in words, codes, schemes or in any form which is capable, when incorporated in a machine readable medium, of causing a computer-electronic or similar device having information processing capabilities to perform or achieve a particular task or result.

The words "schemes or in any other form" would seem to indicate that the source code and object code of a computer programme are entitled to copyright protection.

A source code is a computer programme written in any of the several programming languages employed by computer programmers. An object code is the version of a programme in which the source code language is converted or translated into the machine language of the computer with which it is to be used. The object code is an adaptation or mechanical translation of the source code entitled to copyright protection.

3.65 Present English law on computer programmes under Section 3(1) of the Copyright, Designs and Patents Act, 1988, (U.K.) literary work includes a computer programme. But the Act does not define what a computer or computer programme is?

3.66 In *Sega Enterprise Ltd. v. Richards* [1983] FSR 73 (interlocutory proceedings) it was held that under the provisions relating to literary works in the Copyright Act, 1956, copyright subsisted in the assembly code programme of a video game and that the machine code programme derived from it was either a reproduction or adaptation of the copyright work.

3.67 In *Apple Computer Inc. v. Computer Edge Pty. Ltd.* [1984] FSR 481 at p. 496 (Fed CT Australia) - it was held that a computer programme consisting of a source code is original literary work. A source code is a computer programme written in any of the several programming languages employed by computer programmers. An object code is the version of a programme in which the source code language is converted or translated into the machine language of the computer with which it is to be used. It was further held that an object code is an adaptation or mechanical translation of the source code within the meaning of the copyright law and copying of the object code was an infringement of the copyright in the source code.

An appeal was allowed holding; (1) the source code of each programme was an original literary work; (2) the object code of a programme was not itself a literary work, for they are merely electrical impulses in a silicon chip, which could neither be perceived by the senses nor were intended to convey and message to a human being and which did not represent words, letters figures or symbols and therefore could not be described as literary work. A pattern of circuits is also in the same position, (3) the object code is not a translation within the primary meaning of that word, and (4) the object code is not the rendering of the source code in another medium (adopting the secondary meaning of the word 'translation'). See *Computer Edge v. Apple Computer* [1986] FSR 537.

In the United States it has been held that an object code is entitled to copyright protection, see *Apple Computer v. Franklin Computer* [1983] 714 F 2nd 1240, referred to in *Computer Edge v. Apple Computer* [1986] FSR 537 at p. 550.

In *Wheelan v. Saslow* [1987] FSR 1 (U.S. Court of appeals) it has been held that copyright protection of computer programmes may extend beyond the programmes' literal Code to their structure, sequence and organisation.

Screen display - computer programme Copyright does not subsist in screen display as a literary work, the screen display being only the product of the programme and not the programme itself. The screen display may be entitled to copyright protection as an artistic work in the nature of photograph or a film. *John Richardson v. Flanders* [1993] FSR 497.

There is no doubt that what the assessee has acquired under the various agreements referred to above is computer software.

6.5 The next question, therefore, which arises is what is copyright in a software. Copyright in the context of software is dealt with in Section 14 which reads as under.:

Section 14 of the Copyright Act, 1957 defines as under.-

14. Meaning of copyright. - For the purpose of this Act, "copyright" means the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely:

(a) In the case of a literary, dramatic or musical work, not being a computer programme,-

(i) to reproduce the work in any material form including the storing of it in any medium by electronic means;

(ii) to issue copies of the work to the public not being copies already in circulation;

(iii) to perform the work in public, or communicate it to the public;

(iv) to make any cinematograph film or sound recording in respect of the work;

(v) to make any translation of the work; (vi) to make any adaptation of the work;

(vii) 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 (t) to (vi);

(b) in the case of a computer programme,-

(i) to do any of the acts specified in Clause (a);

(ii) [to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental]

(c) in the case of an artistic work,-

(i) to reproduce the work in any material form including depiction in three dimensions of a two dimensional work or in two dimensions of a three dimensional work;

(ii) to communicate the work to the public;

(iii) to issue copies of the work to the public not being copies already in circulation;

(iv) to include the work in any cinematograph film;

(v) to make any adaptation of the work;

(vi) to do in relation to an adaptation of the work any of the acts specified in relation to the work in Sub-clauses (i) to (iv);

(d)in the case of a cinematograph film, -

(i) to make a copy of the film, including a photograph of any image forming part thereof;

(ii) to sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions;

(iii) to communicate the film to the public;

(e)in the case of a sound recording,-

(i) to make any other sound recording embodying it;

(ii) to sell or give on hire, or offer for sale or hire, any copy of the sound recording regardless of whether such copy has been sold or given on hire on earlier occasions;

(iii) to communicate the sound recording to the public.

Explanation : For the purposes of this section, a copy which has been sold once shall be deemed to be a copy already in circulation.

Copyright is purely a creation of the Copyright Act, 1957 and the rights which an author of a work has by virtue of creating the work are defined in Section 14 of the Act. These rights are exclusive in nature. However, these rights are subject to various exceptions which are contained in Section 52 of the Copyright Act. Anyone who carries out any of these activities, or authorizes someone else to carry out these activities is liable for primary infringement. This will not be the case, however, if the defendant has the permission of the copyright owner or can show that the activity falls within one of the defences available to them. While the nature of the rights which are granted varies according to the type of work in question, these include the exclusive right to:

(1) copy the work (reproduction right);

(2) issue copies of the work to the public (distribution right);

(3) rent or lend the work to the public (rental or lending right);

(4) perform, show, or play the work in public (public performance right);

(5) broadcast the work (broadcasting right);

(6) include it in a cable-programme service (cable right);

(7) make an adaptation of the work, or do any of the above acts in relation to an adaptation (right of adaptation);

(8) the right to authorize others to carry out any of these activities.

The rights of a copyright owner are sometimes called restricted rights and acts which do not constitute infringement (exceptions contained in Section 52) are called permitted acts. The author P. Narayanan (*supra*) clarifies these rights into five main categories as under-

7.2 Negative right Copyright is not a positive right but a negative right, that is, the right to stop others from exploiting the work without the copyright owners' consent or licence. Thus where, for instance, the work is derived from some other work in which copyright subsists as in the case of translation, adaptation or abridgement of a literary work the author of such work can stop others from exploiting it but cannot himself exploit that work without the consent or licence of the original work from which the work has been derived.

7.3 Right of the purchaser of copyright work. Title acquired by the purchaser of a chattel whilst entitling him to make such use of the chattel as he thought fit, does not enable him to use the chattel in a way which infringed the vendors' copyright. This is so even if the goods were manufactured by the copyright owners' licensee. But this is only the consequence of chattel ownership and nothing in the nature of a licence is involved. The buyer of a book in which copyright exists is just such a buyer; the book, once bought by him, is not thereafter subject to any monopoly rights of the copyright owner but may be dealt with by the buyer entirely as he chooses. The copyright in the literary work of course remains with the copyright owner; the buyer has bought no part of it and remains as he was before his purchase, unable lawfully to enjoy any of those exclusive rights, reproduction, adaptation or the like, which ownership of the copyright preserves exclusively for the copyright owner.

7.4 Multiple nature of right. - Copyright is not a single right but a bundle of rights which can be exploited independently. Further the nature of these rights depends upon the categories of works. There are four categories of works on which copyright subsists, namely: (1) original literary, dramatic and musical works, (2) original artistic works, (3) cinematograph films, and (4) sound recording. The exclusive right conferred by the Act on these categories are different. Literary, dramatic and musical works are grouped together for the purpose of defining the exclusive rights. The rights relating to artistic works are different; as also those of cinematograph films and sound recordings.

7.5 Economic rights. - The rights conferred by Section 14 on a copyright owner are economic rights because the exploitation of the work by the exercise of these rights may bring economic benefit to the author of the copyright. He may exploit the work himself or licence others to exploit any one or more of the rights for a consideration which may be in the form of royalty or a lump sum payment.

7.6 Moral rights of the author. - Apart from the economic rights conferred by statute the author of a work has certain moral rights which are recognized by the general law of the land in all civilized

countries. These are (1) the right to decide whether to publish or not to publish the work (droit de divulgation - the right of publication); (2) the right to claim authorship of a published or exhibited work (droit a la paternite - the right of paternity); and (3) the right to prevent alteration and other actions that may damage the author's honour or reputation (droit au respect de loeuvre - the right of integrity). These rights were originated by France and hence the French titles. The Berne Convention (Article 6 bis) recognizes some of these rights and requires member States to provide the author with the right to claim authorship and to object to alterations. These rights remain with the author even after the transfer of copyright and the protection lasts during the whole of the copyright term.

The special feature of the rights conferred on computer programme are the rights referred to in Section 14(b)(ii) which are comparable with the rights conferred on cinematograph films under Section 14(d)(ii) and sound recording under Section 14(e)(ii) which reads as under:

Section 14(b)(ii) [to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme: Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental];	Section 14(d)(ii) to sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions;	Section 14(e)(ii) to sell or give on hire, or offer for sale or hire, any copy of the sound recording regardless of whether such copy has been sold or given on hire on earlier occasions;
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The genesis of these special rights to these three categories of rights has been explained in Intellectual Property Law by Lionel Bently & Brad Sherman Oxford Indian Edition at pages 43, 44, 130, 132 in the following terms:

7.1 Computer Programmes Directive (1991).-The first European initiative in the copyright field was the Computer Programmes Directive, which had to be implemented by 1-1-1993. The Computer Programmes Directive addressed the question of whether computer programmes should be protected by copyright, patents or a sui generis right. Fearing that the member States might have responded differently, the Commission sought a swift and unified response. After consulting with interested parties, it was decided that computer programmes should be protected by copyright. This is reflected in the fact that the Directive requires member States to protect computer programmes as literary works under the Berne Convention. To ensure that this operates as a matter of substance as well as form, the Directive also harmonized the criteria of protection. Prior to the Directive, there were wide divergences as to what member States required of computer programmes before



they could be regarded as original, with German Law setting the level of originality at a particularly high level. Ultimately, the Directive requires member States to protect computer programmes as long as they are original in the sense that they are their author's own intellectual creation.

The Computer Programmes Directive also goes some way to harmonizing the protection member States must give to computer programmes. More specifically, the Directive requires member States to confer certain rights on the owners of copyright in computer programmes, including the right to control temporary reproduction, the running and storage of the programme, the translation or adaptation, distribution or rental of programmes; as well as certain liabilities for 'secondary infringers'. The Directive also requires member States to recognize certain exceptions to the exclusive rights. Negotiations over these exceptions caused intense and acrimonious lobbying in Brussels. Ultimately, the Directive requires member States to enact four exceptions. First, as regards acts done by a lawful acquirer of a programme which are necessitated by use of the programme for its intended purpose. Second, to allow the making of back-up copies. Third, to permit the studying and testing of the programme. Fourth, and most controversially, to permit - in very limited circumstances - the decompilation of programmes.

7.2 Rental directive (1992). - The Rental Directive is in two parts, one part dealing with the specific issues of rental and lending, the other dealing with related rights. The second part comes as close to the codification of copyright as any of the European Directives. Most of the provisions in the Directive had to be implemented by 1-7-1994.

Chapter 1 of the Directive was drafted in response to the increasing economic importance of home rental as a source of revenue for copyright owners. Some member States had decided to confer a rental right, and some had adopted provisions relating to the public lending of works. The Directive attempts to avoid the development of divergent approaches by harmonizing the law relating to rental and lending. It requires member States to confer on authors (of works within the Berne Convention), performers, phonogram producers, and film producers the exclusive right to control the rental and lending of copies (or in the case of performers, fixations) of their works. However, member States are given a number of options: sometimes in derogation from the exclusive rights. The most important of these is the option not to recognize an exclusive right to authorise 'public lending' if authors receive remuneration of some sort for such lending. Member States may also exempt certain establishments from the payment of remuneration for lending.

Chapter 1 of the Directive also includes some interesting provisions on the ownership of the rental right. The Directive recognized the need for creators to obtain an 'adequate income as a basis for further creative and artistic work'. As a result, a fiercely debated provision requires member States to confer on authors and performers and 'unwaivable right to equitable remuneration' when copies of films or phonograms are rented. In turn, it was decided that this required further definition of who is the author of a cinematographic or audiovisual work (a matter on which there are wide divergences under the laws of different countries). The Directive requires that member States recognize that the 'principal director' is one of the authors of such a work.

3. Issuing copies of the work to the public : the distribution right.-The owner of copyright in all categories of work is given the right to issue copies of the work to the public (Section 18). This is commonly known as the 'distribution right'. Section 18 explains that issuing copies of a work to the public means:

- (a) the act of putting into circulation in the EEA copies not previously put into circulation in the EEA by or with the consent of the copyright owner; or
- (b) the act of putting into circulation outside the EEA copies not previously put into circulation in the EEA or elsewhere.

The distribution right is given in respect of the issuing of each and every copy (including the original). As such it needs to be distinguished from a right to make the works available to the public for the first time (that is a 'publication' or 'divulcation' right of the kind previously recognized in UK Law). Essentially the distribution right is a right to put tangible copies (which have not previously been put into circulation) into commercial circulation. Once copies are in circulation (at least where the first circulation was consensual), the right no longer operates. As the right of distribution does not include 'any subsequent distribution', copyright owners cannot control resale.

It is important to note that the distribution right incorporates certain geographical distinctions. In particular, the distribution right was drafted to recognize the principle of Community-wide exhaustion. That is, once tangible copies have been placed on the market in the EEA, a copyright owner cannot utilize national rights to prevent further circulation within the EEA. The corollary of Community-wide exhaustion was that there was no 'international exhaustion. This means that the distribution right can be used to prevent importation of copies of the work into the EEA. Community exhaustion is maintained because the act of issuing is deemed not to include 'any subsequent distribution, sale, hiring or loan of copies previously put into circulation... or any subsequent importation of such copies into the UK or another EEA State. Consequently, if a copy is put on the market in the Netherlands and then imported into and sold in the UK, the importation and sale in the UK does not infringe the issuing right. This might even be the case if the copy placed on the market in the Netherlands is an infringing copy. (However, in these circumstances the importation may constitute a secondary infringement). In contrast, since there is no international exhaustion, the issuing right may be invoked to prevent the parallel importation into the UK of copies marketed outside the EEA by or with the consent of the relevant copyright owner'.

4. Rental and lending rights. - While subsequent distribution of copies of the work is not generally within the copyright owner's control, the owner of the copyright does have the right to control the rental and lending of the work. When the 1988 Act was first enacted, it provided a limited right to control the rental of copies of sound recordings, films, and computer programmes. No such right was given in relation to literary, dramatic, musical or artistic works. However, as a result of amendments implementing the Rental Rights Directive, copyright in literary, dramatic or musical works, as well as artistic works (other than works of architecture or applied art) are granted an exclusive right to rent and lend copies of such works to the public (Section 18A). The rental right is not exhausted by the first sale of copies of the work.

6.6 The nature of the rights granted varies according to the type of work in question. These include the exclusive right to:

- (1) Copy the work (reproduction right);
- (2) Issue copies of the work to the public (distribution right);
- (3) Perform, show, or play the work in public (public performance right);
- (4) Rent or lend the work to the public (rental or lending right);
- (5) Make an adaptation of the work, or do any of the above acts in relation to an adaptation (right of adaptation);
- (6) The right to authorise others to carry out any of these activities.

The first and most well-known right given to copyright owners is the right to copy the work. The right to copy the work is the oldest of the rights granted to owners of copyright. While the right applies to all works, the scope of the right varies depending on the type of subject-matter in question. One factor that is common to all works is that infringement takes place whether the copy is permanent, transient, temporary or incidental to some other use of the work. This means a person will infringe (in the absence of Section 52) when they reproduce a copyright work on a computer screen, or store it in computer memory, as much as when they copy the work from disk to disk. The owner of copyright in all categories of work is given the right to issue copies of the work to the public. This is commonly known as the 'distribution right' and is given in respect of the issuing of each and every copy including the original. Essentially the distribution right is a right to put tangible copies (which have not previously been put into circulation). The significance of the words "not being copies already in circulation" is that once copies are in circulation the right no longer operates. As the right of distribution does not include the right of redistribution, copyright owners cannot control resale of the work. Once tangible copies have been placed in the market, a copyright owner cannot use any further rights to prevent further circulation. Thus, once a book is sold to a member of the public the copyright holder of the book cannot exercise his right, his distribution or his right to issue of the copy of the work to prevent that member of the public from reselling the book. This is so because the right of distribution exhausts itself when the book is originally sold. However, with regard to cinematograph film, sound recording and computer programmes an additional right is conferred viz, to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme or film or sound recording. The question arises as to why this distinction is drawn between these three categories of work and literary, dramatic, musical or artistic works?

The genesis of this additional right being conferred is to be found in the development of the history of an International Copyright Law. The five most significant treaties in International Copyright Law which have contributed to the development of Copyright Law are:

(1) Berne Convention (2) Rome Convention (3) TRIPS (4) WIPO Copyright Treaty (5) WIPO Performances and Phonograms Treaty In the Berne Convention which was revised several times certain minimum standards of protection to copyright owners and authors. These included the right to reproduce the work, to perform the work publicly, to translate the work, to adapt the work, and to broadcast the work. It also created certain exceptions relating to normal exploitation of the work, and provided protection to last at least for the life of the author, plus fifty years thereafter. The Berne Convention was limited in its scope and did not offer protection to performers, producers of sound recordings, broadcasters, publishers, and many others. There was a need to expand the scope of copyright. This was provided for by the Rome Convention. The TRIPS agreement contained certain additional features on aspects of copyright in response to new technologies that gave rise to new sorts of works and new modes of distribution. For example, under TRIPS, protection was required to be given to computer programmes as literary works within the Berne Convention [TRIPS Article 10(1)]. Having regard to the impact of new modes of distribution, members were required to give copyright owners the right to authorise rental of computer programmes, cinematographic works, and phonograms. [TRIPS Article 11, Article 14(4)]. In December 1996, WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty was signed requiring the contracting parties to provide copyright owners with the exclusive right of distribution of fixed copies that can be put into circulation as tangible objects (WCT Article 6). In addition, contracting parties were required to provide copyright owners whose works are embodied in phonograms, computer programmes and cinematographic work with the exclusive right to authorise the commercial rentals of those fixed copies (WCT Article 7).

India is a party to all these conventions and agreements. These Articles read as under:

#### Article 10 Computer Programmes and Compilations of Data

1. Computer programmes, whether in source or object code, shall be protected as literary works under the Berne Convention (1971).
2. Compilations of data or other material, whether in machine readable or other form, which by reason of the selection or arrangement of their contents constitute intellectual creations shall be protected as such. Such protection, which shall not extend to the data or material itself, shall be without prejudice to any copyright subsisting in the data or material itself.

Article 11 Rental Rights In respect of at least computer programmes and cinematographic works, a Member shall provide authors and their successors in title the right to authorise or to prohibit the commercial rental to the public of originals or copies of their copyright works. A Member shall be expected from this obligation in respect of cinematographic works unless such rentals has led to widespread copying of such works which is materially impairing the exclusive right of reproduction

conferred in that Member on authors and their successors in title. In respect of computer programmes, this obligation does not apply to rentals where the programme itself is not the essential object of the rental.

#### Article 14 Protection of Performers, Producers of Phonograms (Sound Recordings) and Broadcasting Organisations

1. to 3. \*\* \*\* \*\*

4. The provisions of Article 11 in respect of computer programmes shall apply mutatis mutandis to producers of phonograms and any other right-holders in phonograms as determined in domestic law. If, on the date of the Ministerial Meeting concluding the Uruguay Round of Multinational Trade Negotiations, a Member has in force a system of equitable remuneration of right-holders in respect of the rental of phonograms, it may maintain such system provided that the commercial rental of phonograms is not giving rise to the material impairment of the exclusive rights of reproduction of right-holders.

David Bainbridge - Software Copyright Law Third Edition at pages 60 and 61 draws a distinction between the right to issue copies to the public and right or rental or lending to the public in the following words:

Issue of copies to the public:

The issue to the public of copies of a work by putting into circulation copies, which have not previously been put into circulation infringes copyright and is defined in Section 18. This act applies to all forms of works of copyright. However, the subsequent distribution, sale, hiring or loan or importation of copies lawfully put into circulation does not infringe with the exception of the rental of computer programmes, films and sound recordings which is treated as equivalent to issuing copies to the public. Unless a licence agreement permits rental the licensee must not rent out copies of computer programmes to the public.

In effect, once a copyright owner has allowed copies of his computer software to be issued to the public, he or she cannot subsequently use the public issue right to control further dealings in those particular copies. This might be important where a computer software company operates in several countries and has different pricing structures for those countries. If a software company sells copies of its software to the public in the United Kingdom for £250 and also sells copies to the French public but at a different price (say the equivalent of £150), another company might buy up copies in France and import them into the United Kingdom with the intention of selling the copies to the public there for £ 200, undercutting the software company with its own copies of the software. The company cannot prevent this by relying on the public issue right. If it attempted to prevent the possibility of this happening by the inclusion of terms in the licence agreements purporting to prevent the

subsequent transfer of the software, these will be struck out by the European Court of Justice if it considers the terms to be restrictive and likely to effect trade between Member States of the European Community.

#### Rental or lending to the public:

As from 1-12-1996, renting or lending to the public a copy of a literary, dramatic or musical work, most forms of artistic works, films or sound recordings is a restricted act and will infringe copyright unless authorized by the copyright owner. This is without prejudice to the pre-existing rule as to rental of computer programmes, sound recordings and films being deemed to be within the restricted act of issuing copies to the public.

New Section 18A of the Copyright, Designs and Patents Act, 1988 contains the detail. The new restricted act is wider than the previous and continuing 'rental right' in that it applies to greater number of types of works and lending also is covered. Now, for example, renting a copy of a database of modern art to the public is a restricted act.

Both rental and lending are defined on the basis that a copy of the work (which includes the original) is made available for use on terms that it will or may be returned. Unlike lending, rental is for direct or indirect economic or commercial advantage. Lending under the Public Lending Right Act, 1979 does not infringe.

There are provisions for transfer of the rental right in the case of works included in films or sound recordings. These could be relevant in terms of works included in multimedia encyclopaedia. The author of a work in which rental right subsists has, upon transfer of his or her right, a right to an equitable remuneration.

These rental and lending rights result from compliance with a European Community Directive on rental right and lending right and on certain rights related to copyright in the field of intellectual property. The changes were implemented by the Copyright and Related Rights Regulations, 1966.

Therefore, as far as computer programmes are concerned, the right to sell or give on commercial rental or offer for sale or for commercial rental is a right independent of the right to reproduce, the right to issue copies of the work etc. The question, therefore, for consideration is whether any of the vendors under the agreement with the appellant have transferred to the appellant the right to use any of the rights viz., reproduction right, distribution right or rental or lending right. A perusal of the agreements would indicate that none of the agreements give the assessee any reproduction right or any distribution right. It is the case of the Assessing Officer that what the assessee has got is the right under Section 14(b)(ii) of the Copyright Act. The Assessing Officer has lost sight of the fact that there is a distinction between "the right to sell or give on commercial rental or offer for sale or for commercial rental"

and exercise of that right by the various parties. What the Vendors have given to the assessee is a consequence of the exercise of the right under Section 14(b)(ii) and not a transfer of the right under Section 14(b)(ii). This distinction has been lost sight of by the Assessing Officer. In fact in each and every agreement clearly the Vendors have retained to themselves the copyright in no uncertain terms. For example, in the agreement with Microsoft, Exhibit 6, Clause 4 reads as under:

#### 4. Miscellaneous

(a) All Confidential Information and Confidential Materials are and shall remain the property of MRS. By disclosing information to COMPANY, MRS does not grant any express or implied right to COMPANY to or under MICROSOFT patents, copyrights, trademarks, or trade secret information.

Similarly Clause 7 reads as under:

#### 7. Distributors duties

(i) If MRS so requests, the Distributor shall assist MRS or any affiliate of MRS in preventing, investigating and prosecuting any infringement of the Products by any person. The Distributor agrees to promptly inform MRS or, if directed by MRS, a specified affiliate of MRS (including Microsoft Corporation or MO), of any unauthorised copying or copies of Products which come to the Distributor's attention.

(ii) Refrain from making copies of any diskettes or documentation related to any Microsoft software product for any purpose without the prior written consent of MO, MRS or Microsoft Corporation.

It is, therefore, clear that none of the exclusive rights in a work have been transferred to the appellant. The exclusive rights in a work are the reproduction right, distribution right, rental or lending right etc. These rights have not been transferred to the appellant. What all the appellant is doing is using the software and/or acting as a distributor of the software. This brings up the question as to whether there is a distinction between the transfer of a copyright per se and a copyrighted article.

The Author, P. Narayanan in Copyright and Industrial Designs - Third Edition at page 79 draws a distinction between copyright in a work and the ownership of the physical material in which the work is fixed. Three paragraphs paras 6.1, 10.1 and 10.5 are reproduced below:

6.1 Who is the owner. - Ownership of copyright in a work is quite independent of the ownership of the physical material in which the work is fixed. A person who owns a book or its manuscript is not necessarily the owner of the copyright therein. As a rule the author of the work is the first owner of the copyright in the work. There are, however, exceptions to this, for example, when the author is an employee and the

work is made in the course of employment or the work is a cinematograph film or sound recording.

Since there is no copyright in ideas even if they are original, the originator of a brilliant idea is not the owner of the copyright in the work which gives concrete form to the idea unless he is also the creator of the work. Thus if a person has a brilliant idea for a story, play or a picture and if he communicates that idea to an author or playwright or an artist the production based on that idea is the copyright of the artist who has clothed the idea in a form whether by means of a book, play or picture and the originator of the idea has no right in the product, for copyright subsists not in ideas but in the tangible form in which it is expressed.

10.1 Exploitation of copyright. - There are a number of ways in which a copyright work can be exploited. In the case of a novel, for instance, it has got various rights which can be separately exploited. It can be published as a volume, or as serially in newspapers and magazines, it can be licenced for translation or filming or dramatisation, and so on. Besides there are separate national rights. Each of these rights can be separately assigned or licenced for a limited term or for the whole of the copyright term. Licences can be exclusive or nonexclusive. An assignment is in essence a transfer of ownership even if it is partial; on the other hand a licence is a permission to do something which but for the licence would be an infringement. A licensee's freedom to alter the work is more limited than that of an assignee. A licensee has no right to assign or sub-licence his interest. If the licence is not exclusive, the licensor can licence the same right to others also. Since registration of assignment is not compulsory the assignee has no means of knowing whether there are prior assignments or licences except through the assignor. He has, therefore, to take some risk. Agreements can be made to assign future copyright works. This will automatically vest ownership in the assignee on the work coming into existence.

10.5 Ownership of copyright and ownership of the work. - Ownership of the copyright in a work is not the same as ownership in the material object in which the copyright work is embodied. Thus a person who buys a painting may be the owner of the canvas in which the painting is drawn but the copyright in the work may vest in the artist who has drawn the painting. Similarly if a person buys a book he is the owner of the book but he has no right to reproduce the work or publish an abridgement or translation or the work. That right belongs to the author or the copyright owner of the book.

Iyengar in Copyright Act, 1957 also draws a distinction between the material object which is the subject of copyright and the copyright itself on page 198 of his commentary which reads as under:

7. Material object which is the subject of copyright is different from copyright. - Copyright is different from the material object, which is the subject of the copyright. So, a transfer of the material object does not necessarily involve a transfer of the copyright. Where the plaintiffs sold certain electroblocks for the purpose of printing certain drawings, and the purchasers lent these blocks to the defendants in order that they, in turn, might print from them, it was held, that the plaintiffs were entitled to restrain the defendants from doing so, notwithstanding the permission of the



purchasers. The sale of the books could not have had the effect of an assignment of copyright.

At the same time, as stated in Copinger, the courts consider that the retention by the vendor of a picture of the copyright therein involves as unnatural dissociation of two kinds of property, and, consequently, they will lean (in ambiguous cases) towards construing any document given at the time of sale as an assignment of copyright.

The distinction between copyright and the material, which is the subject of the copyright, is brought out in Amdur (pp. 22 to 24) in the following words:

The copyright in a book, picture or other work is disconnected and distinct from the general property in the material book, picture or other object. Hence the sale or other transfer of the material object does not, of itself, constitute a transfer of the copyright therein.

Even the transfer of the manuscript of a book will not, at common law, carry with it a right to print and publish the work, without the express consent of author, as the property in the manuscript, and the right to multiply the copies, are two separate and distinct interests.

The Bangalore Tribunal in assessee's own case on identical issue for assessment year 2001-02 and assessment year 2002-03 where in appeal arising out of an order under Section 201 and 201(1A) has held as under:

The payment is for use of copyrights article and not for acquiring any copyright. This view has been arrived at after considering various decisions on the subject as well as the decision of Hon'ble Supreme Court in Tata Consultancy Services' case (supra). We accordingly hold that the payments for import of software do not amount to payment of royalty chargeable under Section 9(1)(vi) of the Act. The payments partakes the character of purchase and sale of goods. Actually, the payee has no permanent establishment in India. Hence it can be concluded that no income is deemed to accrue or arise in India. Accordingly the provision of Section 195 is not applicable to such payment.

6.7 Thus, relying on the above decision, it is held that the copyright in the software is different from any right in the physical manifestation of the software contained in a CD or a floppy or hard disk in which the software is downloaded. Thus when the appellant is a distributor for Acutate Asia Pacific, Cladera or Microsoft, he has not acquired the distribution right which is a copyright within the meaning of Section 14(a)(ii) or the right to sell or give on commercial rental or offer for sale or for commercial rental computer programmes which is a right under Section 14(b)(ii) which continues to remain with Computer Associates Microsoft. The appellant has merely obtained the right to distribute the copyrighted material which is a property

different from the property in the copyright in the software. The property contained in copyrighted material and the property contained in the copyright to software are two different rights and when the assessee acts as a distributor for copyrighted material, he has not acquired the distribution right within the meaning of Section 14(a)(ii) read with Section 14(b)(ii) of the Copyright Act, 1957. If this distinction is not kept in mind the consequence would be something as follows. According to the Assessing Officer the appellant has acquired the copyright, say, Microsoft Office 2000 (a computer programme owned by the Microsoft). If the Assessing Officer is right that the assessee has acquired the copyright in Microsoft Office 2000 then what the assessee has sold is also the copyright in Microsoft Office 2000. The consequence of this is that if the assessee has sold 10,000 copies of Microsoft Office 2000, the copyright is now owned by 10,000 different persons in India. Is this a fair conclusion to draw? It is submitted that this would be an absurd conclusion to draw. The copyright in Microsoft Office 2000 remains vested with Microsoft. In exercise of its right to lend or rent Microsoft Office 2000, Microsoft Corp. has authorised 10,000 different users to use Microsoft Office 2000. In other words Microsoft Corp. is exercising its right under Section 14(b)(ii) viz., the right to sell or give on commercial rental or offer for sale or for commercial rental. That right has not been transferred by Microsoft to anybody and nobody purchasing a copy of Microsoft Office 2000 can again sell it or rent it out as that would be a violation of the exclusive right of selling or giving on commercial rental which vests with Microsoft Corp. under Section 14(b)(ii). Another issue which arises is that if the assessee has acquired a copyright in Microsoft Office 2000 then Microsoft Corp. cannot sell in India even a single copy of Microsoft Office 2000, because the copyright itself has been transferred to the assessee (according to the Assessing Officer). If that be so, then it leads to the absurd conclusion that if Microsoft Corp. sells even a single copy of Microsoft Office 2000 in India or anywhere in the world it would violate the rights of the appellant. This would be an absurd conclusion and consequence. Therefore, the contention of the Assessing Officer (which flows from the misconceived notion of failing to draw a distinction between the copyright and copyrighted article) is wrong. On the other hand if a distinction is drawn between a copyright and a copyrighted article no such absurdity will follow. The copyright would have been with Microsoft Corp. and in exercise of its reproduction right and its distribution right and its rental right each and every copy made, reproduced, distributed, sold or licensed would be in exercise of its copyright under Section 14 and neither the assessee nor any user in India would be violating any right vested with Microsoft Corp. It is well-settled that when an interpretation of an agreement leads to absurd conclusions such an interpretation must be eschewed and rejected. Therefore, when one refers to the agreement, it must be read in the context of what is the right sought to be transferred and the rights sought to be retained by keeping it outside the purview of the agreement.

6.8 Assuming for the sake of argument that copyright has been transferred as contended by the Assessing Officer the requirements of law as to assignation of copyrights have not been complied with. Section 18 and Section 19 of the Copyright

Act, 1957 read as under:

18. Assignment of copyright. - (1) The owner of the copyright in an existing work or the prospective owner of the copyright in a future work may assign to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole of the copyright or any part thereof:

Provided that in the case of the assignment of copyright in any future work, the assignment shall take effect only when the work comes into existence.

(2) Where the assignee of a copyright becomes entitled to any right comprised in the copyright, the assignee as respects the rights so assigned, and the assignor as respects the rights not assigned, shall be treated for the purposes of this Act as the owner of copyright and the provisions of this Act shall have effect accordingly.

(3) In this section, the expression "assignee" as respects the assignment of the copyright in any future work includes the legal representatives of the assignee, if the assignee dies before the work comes into existence.

19. Mode of assignment. - (1) No assignment of the copyright in any work shall be valid unless it is in writing signed by the assignor or by his duly authorised agent.

[(2) The assignment of copyright in any work shall identify such work, and shall specify the rights assigned and the duration and territorial extent to such assignment.

(3) The assignment of copyright in any work shall also specify the amount of royalty payable, if any, to the author or his legal heirs during the currency of the assignment and the assignment shall be subject to revision, extension or termination on terms mutually agreed upon by the parties.

(4) Where the assignee does not exercise the right assigned to him under any of the other sub-sections of this section within a period of one year from the date of assignment, the assignment in respect of such rights shall be deemed to have lapsed after the expiry of the said period unless otherwise specified in the assignment.

(5) If the period of assignment is not stated, it shall be deemed to be five years from the date of assignment.

(6) If the territorial extent of assignment of the rights is not specified, it shall be presumed to extend within India.

(7) Nothing in Sub-section (2) or Sub-section (3) or Sub-section (4) or Sub-section (5) or Sub-section (6) shall be applicable to assignment made before the coming into force of the Copyright (Amendment) Act, 1994.] The mode of assignment is by writing and Section 19(2) requires that the assignment of copyright in any work must:

(1) Identify such work (2) Specify the rights assigned (3) The duration of the assignment (4) The Territorial extent of the assignment.

In none of the agreement which are under consideration are these features provided for. Therefore, there can be no valid assignment within the provisions of Copyright Act, 1957 and therefore, it cannot be contended for the Revenue that what was assigned was a copyright. Therefore, if an assignment is not made validly there can be no assignment of a copyright. The difference between assignment of a copyright and a mere sale or transfer of the work itself is brought out by Lionel Bently and Brad Sherman in Intellectual Property Law Oxford Indian Edition at page 255 in the following terms:

In order for an assignment to be valid, it must be in writing and signed by or on behalf of the assignor. It has been held that sufficient writing might be provided by an invoice or receipt. The assignment should identify the work concerned with sufficient clarity so that it can be ascertained, though the courts have admitted oral ('parol') evidence to assist in the process of identification. No special form of words is required, so a transfer of 'all the partnership assets' will include a transfer of any copyright owned by the partnership. Assignment of copyright is a distinct legal transaction and is not effected by mere sale or transfer of the work itself. Thus, if a person sells an original painting or manuscript, this (of itself) only transfers the personal property right in the chattel: the copyright remains with its owner. If a vendor wishes to transfer the copyright as well as the personal property in the chattel, this should be done explicitly.

6.9 Indian statutory law treats software as goods and levies sales tax, excise and custom duty on it as goods as the extract below indicates:

(a) Custom Tariff Act, 1975:

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T a r i f f   I t e m   D e s c r i p t i o n   o f   G o o d s

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Software :

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8524 40 11	Information Technology Software	8524 91 11	Information Technology Software on floppy disc or cartridge tape
S o f t w a r e	o n   d i s c	o r	o n   C D   R O M

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(b) Bombay Sales Tax Act, 1959:

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E n t r y   N o .   D e s c r i p t i o n   o f   G o o d s

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26 Goods of incorporated or intangible character, that is to say-

( 5 ) S o f t w a r e p a c k a g e s

(c) Central Excise Tariff Act, 1985:

T a r i f f I t e m D e s c r i p t i o n o f G o o d s

85.24 Records, Tapes and other media for sound or other similarly recorded phenomena, including matrices and masters for the production of records.

8 5 2 4 . 2 0 S o f t w a r e

Further the controversy whether software is tangible property or intangible property has been set to rest by Supreme Court in the case of Tata Consultancy Services v. State of Andhra Pradesh , wherein it has been held that a transaction of sale of computer software packages as in the assessee's case is clearly a sale of goods within the meaning of Andhra Pradesh General Sales Tax Act, 1957. Relevant extract from decision at page 420 is reproduced below:

We are in agreement with Mr. Sorabjee when he contends that there is not distinction between branded and unbranded software. However, we find no error in the High Court holding that branded software is goods. In both cases, the software is capable of being abstracted, consumed and use. In both cases the software can be transmitted, transferred, delivered, stored, possessed etc. Thus even unbranded software, when it is marketed/sold, may be goods. We, however, are not dealing with this aspect and express no opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or whether the contract is a service contract may arise.

Several other decisions have considered the question in the context of sales tax and custom Acts. The Supreme Court in Associated Cement Co. Ltd. v. Commissioner of Customs had to consider whether custom duty was payable on software imported on the value of the media on which the software was encrypted or whether the value would also include not only the value of the media but also the value of the software encrypted. In this context the Supreme Court had to deal with the question as to whether the software contained on computer disc could be regarded as goods. Under the Custom Act duty was payable on software whether contained on a floppy disc, cartridge tape, on disc or on CD ROM or otherwise. It was argued for the assessee that the transaction between the appellant and the foreign collaborator was for transfer of technology. It was submitted that even Government authorities regarded

it as a contract for service and not for sale of goods and in this regard reliance was placed on the fact that the Reserve Bank of India had required an application to be made for permission to remit foreign exchange in Form A2 which was meant for foreign exchange remittances otherwise than for import of goods. The Court rejected this contention. After setting out the relevant provisions the Supreme Court concluded in para 33 as under:

33. It is true that what the appellants had wanted was technical advice or information technology. Payment was to be made for this intangible asset. But the moment the information or advice is put on a media, whether paper or diskettes or any other thing, that what is supplied becomes chattel. It is in respect of the drawings, designs etc. which are received that payment is made to the foreign collaborations. It is these papers or diskettes etc. containing the technological advice, which are paid for and used. The foreign collaborators part with them in lieu of money. It is, therefore, sold by them as chattel for use by the Indian importer. The drawings, designs, manuals etc. so received are goods on which customs duty could be levied.

The Supreme Court again considered the question in *State Bank of India v. Commissioner of Custom, Bombay*, 2000 as under:

17. The question that arises for consideration is if licence fee charged towards countrywide use of software in the second invoice could be the charges for the right to reproduction and were these added to the price actually paid or payable for the imported goods.... There is no other value of the software indicated in the agreement except the licence fee. Price is payable only for allowing SBI to use the software in a limited way at its own centres for a limited period and that is why the amount charged is called the licence fee. After five years, SBI is required to pay only recurring licence fee. Countrywide use of the software and reproduction of software are two different things and licence fee for countrywide use cannot be considered as the charges for the right to reproduce the imported goods. Under the agreement copying, storage, removal, etc. are under the strict control of Kindle.... SBI can use the software for its internal requirements only. Licence has been given to SBI to use the property of Kindle at its branches and not for reproduction of the software as claimed by the SBI. The words in the agreement are specific that 'SBI shall pay the licensor the initial licence fee and the recurring licence fees for use under the provisions of this agreement'.

The Supreme Court further noted that:

The invoice is for licence fee for right to use countrywide and it is not right to reproduce as claimed by SBI.... There is a complete restraint on SBI which says that SBI shall not use, print, copy, reproduce or disclose the software or development in whole or in part except as is expressly permitted by the agreement nor shall SBI permit any of the foregoing.... Clause 6.5 of the agreement says that SBI shall not

copy or permit copying of software supplied to it by Kindle save as may be strictly required for delivery to license sites. The terms of the agreement also apply to the copies.

This question has arisen also in the US in *South Central Bell Telephone Co. v. Sidney J. Barthelemy* 643 So. 2d 1240. The Supreme Court of Louisiana had to consider the question in the context of the liability to the "city use tax". The relevant statutes read as under:

The city use tax is imposed by § 56-21 of the Code of the City of New Orleans;

There is hereby levied, for general municipal purpose, a tax upon the sale at retail, the use, the consumption, the distribution and the storage for use or consumption in the city of each item or article of tangible personal property, upon the lease or rental of such property and upon the sale of services within the city....

Personal property which may be seen, weighed, measured, felt or touched, or is in any other manner perceptible to the senses. The term tangible personal property shall not include stocks, bonds, notes or other obligations or securities "The pertinent Civil Code provisions are Louisiana Civil Code Articles 461, 471 and 473. Article 461 distinguishes between corporeals and incorporeals providing:

**\*\*1244** Corporeals are things that have a body whether animate or inanimate and can be felt or touched.

Incorporeals are things that have no body, but are comprehended by the understanding, such as the rights of inheritance, servitude's, obligations and right of intellectual property....

The rights acquired by South Central Bell Telephone Co. were referred to on page 9 of the judgment in the following terms:

During the pertinent taxing periods. Bell licensed specified switching system software programmes for use in specific central offices pursuant to license agreements confected out of state with three vendors. AT & T Technologies, Inc., Northern Telecomm and Erickson. Under these license agreements, Bell acquitted the limited right to use such switching system software programmes: the license agreements limited Bell's right to use designated switching system software to designated **\*\*1242** switches in designated telephone central offices. More particularly, the license agreements prohibited Bell's transfer of such software to any switch other than the designated one; prohibited Bell's sub-license, assignment, sale or transfer of the programmes; prohibited Bell's use of the programmes after the license expired; and required that Bell maintain strict confidentiality with regard to the programmes. The license agreements also reserved to the vendors ownership of, and proprietary rights

in the switching system software programmes....

The High Court came to the following conclusion:

To correctly categorize software, it is necessary to first understand its basic characteristics. \*\*1246 in its broadest scope, software encompasses all parts of the computer system other than the hardware, i.e., the machine; and the primary non-hardware component of a computer system is the programme. Horovitz, *supra*, at 183; Kurt Stohlgren, Note. The Nature and Taxability of Computer Software, 22 Washburn L.J. 103, 104 (1982); 77 Mich. L. Rev. at 1152 n. 17 (1979)(defining software expansively as the "obverse of hardware"). In its narrowest scope, software is synonymous with programme, which, in turn, is defined as "a complete set of instructions that tells a computer how to do something". D. Tunick and D. Schechter, State Taxation of Computer Programmes: Tangible or Intangible? Taxes - The Tax Magazine, January 1985 at 54, 56. Thus, another definition of software is "a set of instructions" or "a body of information" Shontz, *supra*, at 162, 167.

When stored on magnetic tape, disc or computer chip, this software or set of instructions, is physically manifested in machine-readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space. Donald H. Sanders, Computers Today, 229, 233 [1988]; Stohigren *supra*, at 105. The computer reads the pattern of magnetized and unmagnetized spaces with a read/write head as "on" and "off", or to put it another way. "O" and "I" [FN4]. This machine-readable language or code is the physical manifestation of the information in binary form. Sanders, *supra* at 167, 233; Stohigren, *supra*, at 105.

FN4. Though not at issue in this case. CD-ROM storage devices work on a similar concept as magnetic storage devices, but instead of using an arrangement of magnetic and unmagnetic spaces, information is stored by burning or pressing tiny pits into a thin coating of metal or other material deposited on the disk, which is then read by use of a laser light. Sanders, *supra*, at 241.

\*12 Ordinarily, at least three programme copies exist in a software transaction : (i) an original, (ii) a duplicate and (iii) the buyer's final copy on a memory device. 77 Mich. L. Rev. at 1154 n. 27. More basically, "[A] programme copy is developed at the seller's computer. To deliver a copy to the buyer, the seller duplicates the programme copy on software and transports the duplicates to the buyer's computer. The duplicate is read into the buyer's computer and copied on a memory device 77 Mich. L Rev. at 1154 n. 27.

(2) South Central Bell argues that the software is merely "knowledge" or "intelligence" and as such is not corported and thus not taxable. We disagree with South Central Bell's characterization. The software at issue is not merely knowledge but rather is knowledge recorded in a physical form which has physical existence,



takes up space on the tape, disc, or hard drive, makes physical things happen and can be perceived by the senses. See e.g., *Crockett*, supra, at 189-90. As the dissenting Judge at the court of appeal pointed out "In defining tangible 'seen' is not limited to the unaided eye, 'weighed' is not limited to the butcher or bathroom scale and measured is not limited to a yardstick" 93-1072. at p. 8-9 631 So 2d at 1348 (dissenting opinion). That we use a read/write head to read the magnetic or unmagnetic spaces is no different than any other machine that humans use to perceive those corporeal things which our naked senses cannot perceive. See *Crockett*, supra, at 871-72; *Shontz*, supra, at 168; *Cowdrey*, supra, at 198-99.

The software itself, i.e., the physical copy, is not merely a right or an idea to be comprehended by the understanding. The purchaser of computer software neither desires nor receives mere knowledge, but rather receives a certain arrangement of matter that will make his or her computer perform a desired function. This \*13 arrangement of matter, physically recorded on some tangible medium, constitutes a corporeal body.

(3) We agree with Bell and the court of appeal that the form of the delivery of the software magnetic tape or electronic transfer via a modem - is of no relevance. However, we disagree with Bell and the court of appeal that the essence or real object of the transaction was intangible property. That the software can be transferred to various \*\*1247 media, i.e., from tape to disk or tape to hard drive, or even that it can be transferred over the telephone lines, does not take away from the fact that the software was ultimately recorded and stored in physical form upon a physical object. See *Crockett*, supra, at 872-74; *Shontz*, supra, at 168-70; *Cowdrey*, supra at 188-90. As the court of appeal explained and as Bell readily admits the programmes cannot be utilized by Bell unit they have been recorded into the memory of the electronic telephone switch. 93-1072 at p. 6. 631 So. 2 d at 1343. The essence of the transaction was not merely to obtain the intangible "knowledge" or "information" but rather, was to obtain recorded knowledge stored in some sort of physical form that Bell's computers could use. Recorded as such the software is not merely an incorporeal idea to be comprehended and would be of no use if it were. Rather, the software is given physical existence to make certain desired physical things happen.

One cannot escape the fact that software, recorded in physical form, becomes inextricably intertwined with or part and parcel of the corporeal object upon which it is recorded, be that a disk, tape hard drive or other device. *Crockett*, supra, at 371-72, *Cowdrey*, supra at 188-90. That the information can be transferred and then physically recorded on another medium and does not make computer software any different than any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape, or books.

"14 The court of appeal rejected the analogy of computer software to such media as motion pictures, books, video tape, audio tape etc....which are taxable. Like the court of appeal the earlier jurisprudence from other states uniformly rejected the analogy to such other artistic works, finding computer software distinguishable in several respects. [FN5] More recent jurisprudence from other states, however, has recognized the appropriateness of such analogy, as have numerous commentators.

[FN6]. The court of appeal distinguished the purchase of these types of storage devices, such as books, films, video and audio tapes, etc....which hold stores, ideas, information and knowledge in physical form, by reasoning that the true essence of such transactions is the purchase of the tangible medium, not the intangible property (the artist's expressions) contained in that medium and that without the specific tangible medium, the artist's expressions are useless, whereas computer software is separable from the tangible object upon which it is recorded. This distinction simply does not exist. As the dissenting Judge at the court of appeal pointed out:

FN 5 Sec e.g. *First National Bank of Springfield v. Department of Revenue*. 85 III 2 d 84, 51 III Dec, 667, 421 NE 2 d 175, 178 (III 198) : *Commerce Union Bank v. Tidwell*, 538 S.W. 2 d 405, 408 (1976) : *State v. Central Computer Services. Inc....* 349 So 2 d 1160. 1162 (Ala. 1977).

FN 6. See e.g. *Comptroller of the Treasury v. Equitable Trust Co.* 296 Md 459, 464 A 2 d 248 (1983) : *Chittenden Trust Co. v. King* 465 A, 2 d 1100, 1102(1983) : *Citizen and Southern Sys... Inc... v. South Carolina Tax Comm'n* 280 S.C. 138, 311 S.E. 2 d 717 (1984) : *Hasbro Industries. Inc. v. Norberg* 487 A. 2 d 124, 128 (R.I. 1985) : *Shontz, Supra* : *Harris, supra* at 184 : *Crockett, supra* at 866-67 [1] it is now common knowledge that books, music and even movies or other audio/visual combinations can be copied from one medium to another. They are also all available on computer in such forms as floppy disc, tape and CD-ROM. Such movies, books, music etc.... can all be delivered by and/or copied from one medium to another including electrical impulses with the use of a medium. Assuming there is sufficient memory space available in the computer hard disc drive such movies, books, music, etc.... can all be recorded into the permanent memory of the computer such as was done with the software in this case.

93-1072, at p. 4-5, 631 So. 2 d at 1346-47 [dissenting opinion]. See also *Shontz. supra*, at 168-170 : *Harris, supra* at 187.

That the information knowledge, story, or idea, physically manifested in recorded form can be transferred from one medium to \*15 another does not affect the nature of that physical manifestation as corporeal, or tangible. *Shontz, supra* at 168-170 Likewise, that the software can be transferred from, "1248 one type of physical recordation, e.g., tape, to another type, e.g., disk or hard drive, does not alter the nature of the software, *Shontz, supra*, at 168-170: it still has corporeal qualities and is inextricably intertwined with a corporeal object. The software must be stored in physical form on some tangible object somewhere. *Shontz supra*, at 169; *Crockett, supra*, at 871-72; *Harris, supra*, at 187 n. 149. The software was reduced to physical form and recorded on a tangible object prior to delivery to Bell and Bell maintained the software in physical form on a tangible object the computer hard drive. If Bell chooses to so store and use the software in the City of New Orleans. It must pay the use tax imposed on such tangible personal property....

In reaching this conclusion the Court drew a distinction between the exclusive right that intellectual property known as copyright and the rights to a particular copy of the copyrighted work in the following extracts at page 16 as follows:

**\*\*1249** This distinction between the right to the software and a copy of the software was aptly articulated by a noted commentator as follows:

[A] distinction is made between the intellectual property in a work and the tangible property that embodies the work....

The exclusive rights that constitute the intellectual property known as copyright are different from rights to a particular copy of the copyrighted work. When one buys a copy of a copyrighted novel in a bookstore or a recording of a copyrighted song in a record store, one acquires ownership of that particular copy of the novel or song but not the intellectual property in the novel or song. In other words, by acquiring a copy of a copyrighted work, one does not require the copyright the intellectual property.

C. Samuel, Louisiana's Offense Against Intellectual Property - What Exactly is the Offense and is it Preempted by the United States Copyright Law? 37 La. Bar J. 157, 158 (1989). See also 18 C.J.S. Copyright §§ 2.26 (1990) : Cowdrey, supra, at 204-08. We find this distinction a valid one under Louisiana property law and thus classify the intellectual property rights to software as incorporeal as is clearly set out in Civil Code Article 461 and as is explained by Planiol, I Planiol at No. 2248 and classify the actual software copy itself as corporeal.

We reject Bell's argument that what was purchased was the license or right to use the computer software and that such license is intangible. In *Saenger Realty Corp. v. Grosjean*, 194 La. 470, 193 So. 710 (1940), which involved taxation of the rental of motion pictures, we rejected the taxpayer's argument that the right or license to exhibit copyrighted films was intangible. Adopting the reasoning from a New York case, we stated that the transaction which is the subject of the tax under review consists of the transfer by the distributor to the exhibitor of the possession of corporeal property in the form of positive and negative prints of photoplays with the license to use or exhibit them for a specified time. The license to exhibit without the \*18 transfer of possession would be valueless. 193 So at 712 quoting *United Artist Corp. v. Taylor* 273 N.Y. 334, 341, 7 N. 2 d 254, 256 (1937). Hence, we found that the license to exhibit the films was inseparable from the tangible film prints. Likewise the license to use the software, without transferring the software, would be of no use to Bell and the license to use the software is inseparable from the physical manifestation of the software in recorded form....

"In sum, once the "information" or "knowledge" is transformed into physical existence and recorded in physical form, it is corporeal property. The physical recordation of this software is not an incorporeal right to be comprehended.

Therefore we hold that the switching system software and the data processing software involved here is tangible personal property and thus is taxable by the City of New Orleans.

In Hasbro Industries Inc. (487 A. 2d 124) Supreme Court of Rhode Island had to consider a similar provision which reads as under:

Use taxes are imposed on the storage, use or other consumption in this state of tangible personal property. G.L. 1956 (1980 Reenactment) § 44-18-20. Section 44-18-16 defines "tangible personal property" as "property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses".

The Court held that a software programme constituted tangible property in the following terms:

Hasbro argues that the software programme is not "perceptible to the senses" because it consists of invisible, inaudible electronic impulses that instruct the computer to display stored data in a particular manner. Thus, Hasbro concludes that the programme qualifies as intangible personal property that is not subject to the use tax. We disagree.

The programme, which consists of the disk and punch cards, can be seen, weighed and measured and is perceptible in other ways to the senses. Although Hasbro is correct to say that invisible, inaudible electronic impulses instruct the computer, it is nevertheless true that these impulses do not simply float in space but are conveyed to the computer by way of the Treasury v. Equitable Trust Co. 296 Md. 459, 484, 464A. 2 d 248, 261 (1983). The software programme in this case is no different from other taxable personal property such as films, videotapes, books, cassettes and records whose value lies in their respective abilities to store and later display or transmit their contents. Chittended Trust Co. v. King 143 Vt. 271, 274, 465A. 2 d 1100, 1102 (1983). Therefore, we hold that the software programme purchased by Hasbro \*129 constitutes "tangible personal property" for purpose of the state use tax.

FN 7. The programme's function is analogous to that of a stencil: it is used to transfer a pattern of coded instructions that alter the internal structure of the computer and enable it to perform its task. Note 63 B.U.L. Rev. at 204 & 205, n. 138.

Thus, it will be seen that independent of the question under the Copyright Act under Indian Statutory Law, the Supreme Court has concluded that software on media is goods and a similar view holding that software on media or otherwise is goods has been reached in the USA by the Supreme Court of Louisiana and the Supreme Court of Rhode Island. Even the CBDT in its Notification No. 452 (243 ITR 0025A) directed that software or articles and things for the purposes of Section 35 of the Act. Once it is established that the transactions under the Distributor Agreements are transaction

of purchase of goods/software products, Circular No. 23, dated 23-7-1969 of the CBDT comes into picture which clarifies that when a non-resident entity supplies goods from outside India on FOB basis then the profits on such sale do not accrue or arise in India and accordingly such profits are not liable to tax in India under the Act. This clarification has been reiterated in recent CBDT Circular No. 786 [242 ITR 132].

6.10 A similar view has been taken by the OECD in its model commentary in paras 12 to 17 dealing with the payment of software which read as under:

12. Whether payments received as consideration for computer software may be classified as royalties poses difficult problems but is a matter of considerable importance in view of the rapid development of computer technology in recent years and the extent of transfers of such technology across national borders. In 1992, the Commentary was amended to describe the principles by which such classification should be made. Paragraphs 12 to 17 were further amended in 2000 to refine the analysis by which business profits are distinguished from royalties in computer software transactions. In most cases, the revised analysis will not result in a different outcome.

12.1 Software may be described as a programme, or series of programmes, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing or electronically, on a magnetic tape or disk, or on a laser disk or CD-Rom. It may be standardised with a wide range of applications or be tailor-made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware.

12.2 The character of payments received in transactions involving the transfer of computer software depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the programme. The rights in computer programmes are a form of intellectual property. Research into the practices of OECD member countries has established that all but one protects rights in computer programmes either explicitly or implicitly under copyright law. Although the term "computer software" is commonly used to describe both the programme in which the intellectual property rights (copyright) subsist and the medium on which it is embodied, the copyright law of most OECD member countries recognises a distinction between the copyright in the programme and software which incorporates a copy of the copyrighted programme. Transfer of rights in relation to software occur in many different ways ranging from the alienation of the entire rights in the copyright in a programme to the sale of a product which is subject to restrictions on the use to which it is put [Emphasis supplied]. The consideration paid can also take numerous forms. These factors may make it difficult to determine where the boundary lies between software payments that are properly

to be regarded as royalties and other types of payment. The difficulty of determination is compounded by the ease of reproduction of computer software, and by the fact that acquisition of software frequently entails the making of a copy by the acquirer in order to make possible the operation of the software.

13. The transferee's rights will in most cases consist of partial rights or complete rights in the underlying copyright (see paragraphs 13.1 and 15 below), or they may be (or be equivalent to) partial or complete rights in a copy of the programme (the "programme copy"), whether or not such copy is embodied in a material medium or provided electronically (see paragraphs 14 to 14.2 below). In unusual cases, the transaction may represent a transfer of "know-how" or secret formula (paragraph 14.3).

13.1 Payments made for the acquisition of partial rights in the copyright (without the transferor fully alienating the copyright rights) will represent a royalty where the consideration is for granting of rights to use the programme in a manner that would, without such license, constitute an infringement of copyright. Examples of such arrangements include licenses to reproduce and distribute to the public software incorporating the copyrighted programme, or to modify and publicly display the programme. In these circumstances, the payments are for (the right to use the copyright in the programme (i.e., to exploit the rights that would otherwise be the sole prerogative of the copyright holder). It should be noted that where a software payment is properly to be regarded as a royalty there may be difficulties in applying the copyright provisions of the Article to software payments since paragraph 2 requires that software be classified as a literary, artistic or scientific work. None of these categories seems entirely apt. The copyright laws of many countries deal with this problem by specifically classifying software as a literary or scientific work. For other countries treatment as a scientific work might be the most realistic approach. Countries for which it is not possible to attach software to any of those categories might be justified in adopting in their bilateral treaties an amended version of paragraph 2 which either omits all references to the nature of the copyrights or refers specifically to software.

14. In other types of transactions, the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the programme, for example, where the transferee is granted limited rights to reproduce the programme. This would be the common situation in transactions for the acquisition of a programme copy. The rights transferred in these cases are specific to the nature of computer programmes. They allow the user to copy the programme, for example onto the user's computer hard drive or for archival purposes. In this context, it is important to note that the protection afforded in relation to computer programmes under copyright law may differ from country to country. In some countries the act of copying the programme on to the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of

many countries automatically grant this right to the owner of software which incorporates a computer programme. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, copying the programme on to the computer's hard drive or random access memory or making an archival copy is an essential step in utilising the programme. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the programme by the user, should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as commercial income in accordance with Article 7.

14.1 The method of transferring the computer programme to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the programme or directly receives a copy on the hard disk of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software.

14.2 The ease of reproducing computer programmes has resulted in distribution arrangements in which the transferee obtains rights to make multiple copies of the programme for operation only within its own business. Such arrangements are commonly referred to as "site licences", "enterprise licenses", or "network licences". Although these arrangements permit the making of multiple copies of the programme, such rights are generally limited to those necessary for the purpose of enabling the operation of the programme on the licensee's computers or network, and reproduction for any other purpose is not permitted under the license. Payments under such arrangements will in most cases be dealt with as business profits in accordance with Article 7.

14.3 Another type of transaction involving the transfer of computer software is the more unusual case where a software house or computer programmer agrees to supply information about the ideas and principles underlying the programme, such as logic, algorithms or programming languages or techniques. In these cases, the payments may be characterised as royalties to the extent that they represent consideration for the use of, or the right to use, secret formulas or for information concerning industrial, commercial or scientific experience which cannot be separately copyrighted. This contrasts with the ordinary case in which a programme copy is acquired for operation by the end user.

15. Where consideration is paid for the transfer of the full ownership of the rights in the copyright, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there are extensive but partial alienation of rights involving:

- exclusive right of use during a specific period or in a limited geographical area;

- additional consideration related to usage;
- consideration in the form of a substantial lump sum payment.

16. Each case will depend on its particular facts but in general such payments are likely to be commercial income within Article 7 or a capital gains matter within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated in full or in part, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

17. Software payments may be made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. The methods set out in paragraph 11 above for dealing with similar problems in relation to patent royalties and know-how are equally applicable to computer software. Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part.

17.1 The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made.

17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, e.g., because a right to make one or more copies of the digital content is granted under the contract. Where the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for purposes of applying the definition of "royalties".

17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the



payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties but falls within Article 7 or Article 13, as the case may be. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored. This use of copyright is not important for classification purposes because it does not correspond to what the payment is essentially in consideration for {i.e., to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the definition of royalties. There also would be no basis to classify such transactions as "royalties" if, under the relevant law and contractual arrangements, the creation of a copy is regarded as a use of copyright by the provider rather than by the customer.

17.4 By contrast, transactions where the essential consideration for the payment is the granting of the right to use a copyright in a digital product that is electronically downloaded for that purpose will give rise to royalties. This would be the case, for example, of a book publisher who would pay to acquire the right to reproduce a copyrighted picture that it would electronically download for the purposes of including it on the cover of a book that it is producing. In this transaction, the essential consideration for the payment is the acquisition of rights to use the copyright in the digital product, i.e., the right to reproduce and distribute the picture, and not merely for the acquisition of the digital content.

The UN Model Commentary 2001 on Article 12 of UN Model Convention, in paragraph 3 Clauses 12 and 13, observes as under regarding characterisation of payments for softwares:

Whether payments received as consideration for computer software may be classified as royalties poses difficult problems but is a matter of considerable importance in view of the rapid development of computer technology in recent years and the extent of transfers of such technology across national borders. Software may be described as a programme, or series of programmes, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing, on a magnetic tape or disc, or on a laser disc. It may be standardised with a wide range of applications or be tailor-made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware. The rights in computer software are a form of intellectual property. Research into the practices of OECD Member countries has established that all but one protect software rights either explicitly or implicitly under Copyright Law. Transfers of rights occur in many different ways ranging from the alienation of the entire rights to the sale of a product which is subject to restrictions on the use to which it is put. The consideration paid can also take numerous forms. These factors may make it difficult

to determine where the boundary lies between software payments that are properly to be regarded as royalties and other types of payment.

Three situations are considered. The first is of payments made where less than the full rights in software are transferred. In a partial transfer of rights the consideration is likely to represent a royalty only in very limited circumstances. One such case is where the transferor is the author of the software (or has acquired from the author his rights of distribution and reproduction) and he has placed part of his rights at the disposal of a third party to enable the latter to develop or exploit the software itself commercially, for example by development and distribution of it.... Even where a software payment is properly to be regarded as a royalty there are difficulties in applying the copyright provisions of the Article to software royalties since paragraph (3) requires that software should be classified as a literary, artistic or scientific work. None of these categories seems entirely apt but treatment as a scientific work might be the most realistic approach. Countries for which it is not possible to attach software to any of those categories might be justified in adopting in their bilateral treaties an amended version of paragraph 2 which either omits all references to the nature of copyrights or refers specifically to software.

In other cases, the acquisition of the software will generally be for the personal or business use of the purchaser. The payment will then fall to be dealt with as commercial income in accordance with Article 7 or 14. It is of no relevance that the software is protected by copyright or that there may be restrictions on the use to which the purchaser can put it.

The second situation is where the payments are made as consideration for the alienation of rights attached to the software. It is clear that where consideration is paid for the transfer of the full ownership, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there are extensive but partial alienation of rights involving:

- exclusive right of use during a specific period or in a limited geographical area;
- additional consideration related to usage;
- consideration in the form of a substantial lump sum payment.

Each case will depend on its particular facts but in general such payments are likely to be commercial income within Article 7 or 14 or a capital gains matter within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated in full or in part, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are

related to a contingency.

The third situation is where software payments are made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. The methods set out in paragraph 11 above for dealing with similar problems in relation to patent royalties and know-how are equally applicable to computer software. Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part.

The suggestions made above regarding mixed contracts could also be applied in regard to certain performances by artists and, in particular, in regard to an orchestral concert given by a conductor or a recital given by a musician. The fee for the musical performance, together with that paid for any simultaneous radio broadcasting thereof, seems to fall to be treated under Article 17. Where, whether under the same contract or under a separate one, the musical performance is recorded and the artist has stipulated that he be paid royalties on the sale or public playing of the records, then so much of the payment received by him as consists of such royalties falls to be treated under Article 12.

13. Reference is made to the revision of the commentary on Article 12 concerning software payments that has been approved by the OECD Fiscal Affairs Committee which would replace the commentary quoted above.

The OECD, in its report (dated 1-2-2001) on Tax Treaty characterisation issues arising from E-commerce, has further explained, by way of examples, the principles relating to characterisation of payments for software as contained in above quoted commentaries. Example Nos. 1, 2, 3, 4, 5, 6 and 12 as contained in this report are relevant for the present case and hence, are reproduced hereunder for the sake of ready reference and better understanding:

Category 1 : Electronic order processing of tangible products:

Definition - The customer selects an item from an online, catalogue of tangible goods and orders the item electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalogue. The product is physically delivered to the customer by a common carrier.

2. Analysis and conclusions. - Whilst the Group considers that category of transaction as a useful starting point, it does not see it as raising any treaty characterisation issue. In this type of transaction, the payment made by the customer constitutes consideration that clearly falls within Article 7 (Business Profits) rather than Article 12 (Royalties), because it does not involve a use of copyright.

Category 2: Electronic ordering and downloading of digital products:

3. Analysis and conclusions. - The Group found that this category of transaction raised the fundamental characterisation issue discussed in paragraphs 13 to 15 of Section 3 above, i.e., the distinction between business profits and the part of the treaty definition of "royalties" dealing with payments for the use of, or the right to use, a copyright. It concluded that in the case of transactions that permit the customer to electronically download digitised products (such as software, images, sounds or text) for the customer's own use or enjoyment, the payment is made to acquire data transmitted in the form of a digital signal. Since this constitutes the essential consideration for the payment, that payment cannot be considered as royalties as a payment made for the use or the right to use a copyright so as to constitute a royalty. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media (including transfers to other storage, performance or display devices) constitutes the use of a copyright under the relevant law and contractual arrangements, this is merely an incidental part of the process of capturing and storing the digital signal. This incidental part is not important for classification purposes because it does not correspond to the essential consideration for the payment (i.e., to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the treaty definition of royalties.

Category 3: Electronic ordering and downloading of digital products for purposes of commercial exploitation of the copyright:

Definition - The customer selects an item from an online catalogue of software or other digital products and orders the product electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalogue. The digital product is downloaded into the customer's hard disk or other non-temporary media. The customer acquires the right to commercially exploit the copyright in the digital product (e.g., a book publisher acquires, a copyrighted picture to be included on the cover of a book that it is producing).

4. Analysis and conclusions. - The Group considered it useful to refer to this category of transaction in order to illustrate a case where all its members agree that the payment qualifies as a royalty. Indeed, in that case, the payment is made as consideration for the right to use the copyright in the digital product. In the example given, that use takes the form of the reproduction and sale, for commercial purpose, of the copyrighted picture.

Category 4: Updates and add-ons:

Definition - The provider of software or other digital product agrees to provide the customer with updates and add-ons to the digital product. There is no agreement to

produce updates or add-ons specifically for a given customer.

5. Analysis and conclusions - The Group agrees that this category of transaction should be treated:

- like the transactions described in category 1 above if the updates and add-ons are delivered on a tangible medium;
- like the transactions described in category 2 above if the updates and add-ons are delivered electronically.

6. Since both categories 1 and 2 would give rise to payments falling under Article 7, payments made by the customer in this category of transaction should therefore be treated similarly.

Category 5: Limited duration software and other digital information licenses:

Definition - The customer receives the right to use software or other digital products for a period of time that is less than the useful life of the product. The product is either downloaded electronically or delivered on a tangible medium such as a CD. All copies of the digital product are deleted or become unusable upon termination of the license.

7. Analysis and conclusions. - The Group unanimously concluded that, under the OECD Model as currently worded, that transaction should be treated exactly as transactions falling under categories 1 or 2 so that the payment to the commercial provider of the limited duration digital product would fall under Article 7 (Business Profits).

8. Also, if a particular convention includes a definition of royalties that covers "payments for the use of, or the right to use, industrial, commercial or scientific equipment", the Group concluded that such payments cannot be considered as payments "for the use of, or the right to use, industrial, commercial or scientific equipment" for the reasons set out in paragraphs 25 and 26 of Section 3 above.

Category 6: Single-use software or other digital product:

Definition - The customer receives the right to use software or other digital products one time. The product may be either downloaded or used remotely (e.g., use of software stored on a remote server). The customer does not receive the right to make copies of the digital product other than as required to use the digital product for its intended use.

9. Analysis and conclusions - Whilst some members view this type of transaction as contracts for services and others view them as being similar to the transactions referred to in categories 2 and 5, the Group unanimously agreed that payments made in these transactions fall under Article 7 as business profits.

Category 12 : Software maintenance Definition - Software maintenance contracts typically bundle software updates together with technical support. A single annual fee is charged for both updates and technical support. In most cases, the principal object of the contract is the software updates.

19. Analysis and conclusions. - The Group concluded that the remarks expressed in paragraphs 46 to 48 of Section 3 above as regards mixed contracts, which refer to the principles set out in paragraph 11 of the Commentary on Article 12, apply to such transactions. Where, under those principles, part of the payment is regarded to be for the provision of technical support, the issues described in category 14 below as regards alternative treaty provisions that allow source taxation of "technical fees" will arise.

6.11 The Model Commentaries give the authoritative interpretation of the provisions of DTAA's. These are legal aid in interpretation of provisions of Double Taxation Avoidance Agreements entered into by two sovereign countries. The interpretation placed in Model Commentary in relation to a particular provision of the Model Convention would equally apply in interpretation and construction of same provision contained in a DTAA entered into by a member country, unless (i) the wordings of provision contained in a particular DTAA are different from the wordings of similar provision in the Model Convention or (ii) the countries to DTAA intended a different interpretation and such different interpretation is made express by way of protocol or by any other means, or (iii) the relevant member country has recorded its reservations in the Model Commentaries in relation to particular interpretation. This principle has been expressly spelt out both under UN Model Commentary as well as OECD Model Commentary. In this connection, UN Model Commentary, in its Clauses 34 and 36 to introduction, observes as under:

34. The rationale of the preparation of bilateral tax conventions was cogently expressed by the Fiscal Committee of the League of Nations in the following terms:

The existence of model draft treaties...has proved of real use...in helping to solve many of the technical difficulties which arise in [the negotiation of tax treaties]. This procedure has the dual merit that, on the one hand, insofar as the model constitutes the basis of bilateral agreements, it creates automatically an uniformity of practice and legislation, while, on the other hand, inasmuch as it may be modified in any bilateral agreement reached, it is sufficiently elastic to be adapted to the different conditions obtaining in different countries or pairs of countries.

35. \*\* \*\* \*\*

36. If the negotiating parties decide to use in a treaty wording suggested in the United Nations Model Convention, it is to be presumed that they would also expect to derive

assistance in the interpretation of that wording from the relevant commentary. The commentaries, which may prove to be very useful in the implementation of a treaty concluded by the negotiating parties and in the settlement of any dispute relating thereto, are not intended to be annexed to such a treaty, the text of which in itself would constitute the legally binding agreement.

Similarly, the OECD, in Clauses 28 to 30 in introduction to OECD Model Commentaries, at pages 14 and 15, observes as under in respect of importance of commentaries as an aid in interpretation of DTAAs:

28. For each Article in the Convention, there is a detailed Commentary that is intended to illustrate or interpret its provisions.

29. As the Commentaries have been drafted and agreed upon by the experts appointed to the Committee on Fiscal Affairs by the Governments of Member countries, they are of special importance in the development of International Fiscal Law. Although the Commentaries are not designed to be annexed in any manner to the conventions signed by Member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and, in particular, in the settlement of any disputes.

29.1 The tax administration, of Member countries routinely consult the Commentaries in their interpretation of Bilateral Tax Treaties. The Commentaries are useful both in deciding day-to-day questions of detail and in resolving larger issues involving the policies and purposes behind various provisions. Tax officials give great weight to the guidance contained in the Commentaries.

29.2 Similarly, taxpayers make extensive use of the Commentaries in conducting their businesses and planning their business transactions and investments. The Commentaries are of particular importance in countries that do not have a procedure for obtaining an advance ruling on tax matters from the tax administration as the Commentaries may be the only available source of interpretation in that case.

29.3 Bilateral tax treaties are receiving more and more judicial attention as well. The courts are increasingly using the Commentaries in reaching their decisions. Information collected by the Committee on Fiscal Affairs shows that the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the Judge's deliberations. The Committee expects this trend to continue as the world-wide network of tax treaties continues to grow and as the Commentaries gain even more widespread acceptance as an important interpretative reference.

30. Observations on the Commentaries have sometimes been inserted at the request of Member countries that are unable to concur in the interpretation given in the Commentary on the Article concerned. These observations thus do not express any disagreement with the text of the Convention, but usefully indicate the way in which those countries will apply the provisions of the Article in question.

6.12 The Assessing Officer had further referred to certain rulings from US, Australia and Singapore Authorities in respect of software imports. These are dealt with below:

**Singapore** The Assessing Officer has extracted from a Circular dated 29-12-2000 under which the Government of Singapore has exempted "shrink-wrap" software from withholding tax. He has concluded from the extract of the first paragraph of the Circular that because Singapore Government has specifically granted an exemption it follows that import of software as such is covered by a withholding tax. It is submitted that one has to look at the position under the Income-tax Act, 1961 and not be guided by the provisions of a foreign statute unless it is shown what the statute deals with, its provisions and the context of the observations. First of all we do not have before us the provisions of Singapore local law both regards copyright and regards income-tax and in the absence of relevant provisions of the statute no conclusion can be drawn as to the taxing of payments in respect of software. For example, it may well be that Singapore Law provides that payments for software are deemed to be royalty and the circular merely exempts payments for royalty for "shrink-wrap" software from the scope of withholding tax. In any view of the matter, it is not possible to draw any conclusion based on incomplete material.

**United States of America** The Assessing Officer concedes that software programmes are treated as "copyrighted articles". It is for this reason that the Assessing Officer has been forced to consider other attributes like patent, invention, process etc. to bring within the taxing ambit the payment in respect of software. It is therefore clear that software on media acquired by the assessee both for distribution and for its own use is acquisition of "a copyrighted article" and therefore, the US ruling if at all clearly supports the case of the assessee. The so-called contradiction between the Ruling of the IRS and example 3 of the OECD commentary is misplaced. What the example says is clearly supporting the case of the assessee that a "copyrighted article" is different from the transfer of "copyright" and a distinction is required to be drawn between the copyrighted articles and copyright articles. The extract referred to in OECD commentary and the reservations of the US is with reference to the payment made which is related to and measured by reference to the productivity or use of software which may represent royalty. This is in the context of rental for use of equipment which can always represent royalty in view of the expanded definition of royalty in certain DTAA's and does not represent any contradiction in the position taken.



Australia Unfortunately the Assessing Officer has not given reference of the ruling referred to therein. In any case the ruling according to the Assessing Officer reaches the conclusion that the computer software is not royalty and therefore supports the case of the assessee. Therefore both US and Australian views are that software payments do not constitute payment in respect of royalty but payments in respect of a copyrighted article.

Thus, for the detailed reasons stated above it is held that what the assessee has acquired a copyright is misplaced. What the appellant has acquired is copyrighted article, which partakes the character of purchase and sale of goods. Therefore no tax needs to be deducted under Section 195 of the Income-tax Act. These appeals are accordingly allowed.

In the result all the appeals are allowed.