M/S.Zylog Systems Limited vs The Income Tax Officer on 23 April, 2019

Author: V.K

Bench: Vineet Kothari, C.V.Karthikeyan

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 23.4.2019

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE C.V.KARTHIKEYAN

Tax Case Nos.2184 & 2185 of 2006

M/s.Zylog Systems Limited,
82/40, I Main Road, CIT Nagar,
Nandanam, Chennai 600 035. Appell

Vs.

The Income Tax Officer,
International Taxation II,
Chennai Respon

Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras 'B' Bench, Chennai, dated 27.1.2006 made in ITA Nos.2082/Mds/2005 & 2083/Mds/2005.

For Appellant : Mr.S.Gopalakrishnan
Official Liquidator

For Respondent : Mr.Karthik Ranganathan
Senior Standing Counsel assisted by
Mr.S.Rajesh

COMMON JUDGMENT

(Delivered by DR.VINEET KOTHARI,J) The Assessee M/s.Zylog Systems Limited, Chennai now said to be in Liquidation, had filed these Tax Cases under Section 260-A of the Income Tax Act, by raising the following purported substantial questions of law arising from the order passed by the Income Tax Appellate Tribunal dated 27.1.2006, by which the learned Tribunal dismissed the

Appeal filed by http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO the Assessee for the Assessment Years 2001-02 and 2002-03 and upheld the orders passed by the Appellate Authority.

2. The questions on which the present Tax Cases had been admitted by a coordinate Bench of this Court are quoted below for ready reference:-

> "i) Whether the Tribunal was right in holding that the interest levied under Section 201(IA) is legally valid having regard to the provisions of the Income Tax Act and the Double Tax Avoidance Agreement entered into between Indian and USA?
>
> ii) Whether the Tribunal was right in law in holding that the appellant has to deduct tax at source since the payment constituted Royalty?"

3. The facts in brief are as under:-

> The Assessee-Company is engaged in the business of development of Software. The Assessee entered into a Licence Agreement with M/s.Bluestone Software Inc. for getting a licence to use Bluestone's Total e-Business and Universal Business Server, Universal Listener Framework, Scheduler, XMLServer and Visual XML development. The assessee has paid a sum of US $3,00,000 which is equivalent to Indian Rs.1,38,57,2501- towards licence fee. The Assessing Officer treated this payment of US $3,00,000 as Royalty and also treated the Assessee a Assessee-in-default under Section 201(1) of the Income Tax Act. The http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO Assessing Officer has also levied interest under Section 201(IA) of the Income Tax Act. The Assessee, being aggrieved by the order of the Assessing Officer, filed an appeal before the CIT(A). The CIT(A), after elaborately discussing the issue, confirmed the order of the Assessing Officer. Therefore, the Assessee filed Appeals before the Tribunal.

4. The learned Tribunal decided the issue against the Assessee and held that the payment made by the Assessee to the US Company was a payment of 'Royalty' for use of Copyrights, Software and Logo of US Company and was covered by Article 12 of the Double Tax Avoidance Agreement (DTAA) between India and USA and therefore, the Assessee, an Indian Company was liable to deduct tax ii1t sourc,e and pay the same to the State. On account of non-deduction of tax and deposit with the Treasury, the Authorities below also imposed interest under Section 201(IA) of the Act. The relevant portion of the order passed by the learned Tribunal in this regard, is quoted below for ready reference: -

> "19. We have considered the rival submissions on either side, and also perused the material available on record. Admittedly, the assessee entered into an agreement with a foreign company M/s. Bluestone Software Inc. Clause 1.4 of the agreement reads as follows:

"1.4 License to Use BluestoneTrademark/Service Marks.

http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO Bluestone grants to Licensee a worldwide, non- exclusive, non-transferable license to use the trademarks, service marks, notices, and/or logos of Bluestone which are set forth on Exhibit F (which may be updated from time to time by an agreement of the parties) solely to indicate that the Applications contain the Licensed Products and/or for any other purpose specifically authorized by this agreement."

20. From the above clause in the agreement it is very clear that the assessee was given the right to use trademark and logo of the foreign company Mls.Bluestone Software Inc. in order to market the commodity as Licensed Product of Mis. Bluestone Software Inc. Therefore, the assessee was given a right to use the trademark by the foreign company for which the assessee has to pay the amount annually. Clause 1.1 of the agreement reads as follows:

"1.1 License to Develop Applications. Bluestone grants Licensee a worldwide, nonexclusive, non- transferable license to copy, install, test and use the Licensed Products listed on Exhibit A at the Authorized Location to develop, reproduce, market, http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO license and support the Applications listed on Exhibit A."

21. This clause authorises the assessee to copy the product listed on Exhibit A and to reproduce the same or develop the same. Therefore, the agreement between the assessee and the foreign company is not only to use the copy of a copyright of software but to take copies and to develop the same and they are also permitted to market the product with a trademark and logo of the foreign company. For the purpose of this authorisation to use the software, trademark and logo in the product, the assessee is paying the annual fee. Therefore, the question arises for consideration is whether the annual fee paid by the assessee for using the software, trademark and logo would amount to payment of royalty.

22. The contention of the assessee before this Tribunal is that the definition given in Section 9(1)(vi) of the Income Tax Act is very wide, therefore, we have to take the definition given in the Double Taxation Avoidance Agreement entered into between India and United States of America. The assessee has produced a copy of the Double Taxation Avoidance Agreement entered into between India http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO and United States of America. Article 12(3) defines royalty as follows:

"The term "royalties" as used in the Article 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 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) payment of any kind received as consideration for the use of, or right to use, the 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 or Article 8."

23. From a bare reading of the above definition given in http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO the Double Taxation Avoidance Agreement, it is very obvious that any payment received as consideration for use of or right to use copyright or an artistic work or a trademark design or plan would amount to royalty within the meaning of Article 12(3) of the Double Taxation Avoidance Agreement. In. this case, what was paid by the assessee as an annual fee is for the use of software which gives a right to use, copy develop and market the same by using the trademark and logo of Mls.Bluestone Software Inc. Therefore, the payment made by the assessee as annual fee would be for the purpose of using the software for copying and developing and also for using the trademark or logo for marketing the product in Indian market. Therefore, in our opinion, the payment of annual fee by the assessee to Mls.Bluestone Software - Inc. squarely falls within the definition "royalty" as provided in Article 12(3) of the Doubt Taxation Avoidance Agreement. Therefore, we do not find any substance in the argument of the learned representative of the assessee that the payment is not in the form of royalty.

24. The other contention of the learned representative http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO for the assessee is that the recipient Mls.Bluestone Software Inc. is not liable to pay any tax since the payment does not have characteristics of royalty. Since we have concluded that the payment has the characteristics of royalty within the meaning of Article 12(3) of the Doubt Taxation Avoidance Agreement, in our opinion, this contention of the assessee is baseless. Therefore, the payment is liable to be taxed in India. In view of the above, the assessee ought to have deducted tax as provided in Section 195 of the Income Tax Act.

25. We have also carefully gone through the provisions of Sec.9(1)(vi) of the Income Tax Act. As rightly submitted by the learned representative for the assessee, the definition given in Section 9(1)(vi) of the Income Tax Act is very wide in order to cover any payment relating to any right of property or information used for the purpose of business. As we have already observed, the payment of annual fee falls even within the restricted meaning given in Article 12(3) of the Double Taxation Avoidance Agreement. Since a right to copy and develop the software and to use the trademark was given to the assessee in their business, the payment would definitely http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO fall within the definition of Section 9(1)(vi) of the I. T. Act also apart from the definition given in article 12(3) of Double Taxation Avoidance Agreement. Therefore, the inescapable conclusion would be that the annual fee paid by the assessee is a royalty, therefore, is no question of any doubt regarding deduction of tax.

26. Let us now examine the case laws relied upon by the learned representative for the assessee. The final case relied upon by the learned representative is of the Bangalore Bench of this Tribunal in the case of Samsung Electronics Company Ltd. (supra). We have carefully gone through the decision of the Bangalore Bench of this Tribunal. In the case before the Bangalore Bench, the assessee a branch of Samsung Electronics Co. Ltd., Korea engaged in the development, manufacture and export of software for use of its parent company. The software developed by the assessee is for in-house use by the parent company. The assessee imported software product from Tektronix Inc., USA. The assessee has also imported software product from France and Sweden. The assessee contended before the Bangalore Bench of this Tribunal that the software imported by the assessee are readily http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO available in market, therefore, the payment made to software company cannot be treated as royalty. In those factual situations, the Bangalore Bench of this Tribunal found that under Double Taxation Avoidance Agreement, the consideration paid must be for use or right to use any copyright of literary or artistic or scientific work. The Bangalore Bench found that the assessee has received only a copy of the copyright article and the incorporeal right to software remained with owner. Therefore, the Bangalore Bench concluded that the assessee had merely purchased a copy of the copyright article, therefore, the payment does not fall within the. meaning of royalty as provided in Double Taxation Avoidance Agreement. In the case before us/ as per agreement between the assessee and the foreign company Mls.Bluestone Software Inc., clause 1.1 of the Agreement specifically gives a right to copy the licensed product and develop and reproduce the same for marketing. Clause 1.4 of the Agreement authorises the assessee to use the trademark and logo in the product developed or reproduced by the assessee for marketing. Therefore, in the case before us/ it is not a purchase of http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO mere software as in the case of foreign company. In the case before us/ a right to copy/ develop and reproduce the same was specifically given by clause 1.1 of the Agreement. Therefore, in our opinion, the decision of the Bangalore Bench of this Tribunal is not applicable to the facts of this case.

27. The next case relied upon by the learned representative for the assessee is the judgment of the Kerala High Court in the case of Fertilisers & Chemicals Travancore Ltd. (supra). The learned representative relied upon by this judgment for the proposition that the assessee has to deduct tax when the sum payable to the foreign company is chargeable under the Income Tax Act. As we have already discussed, we concluded that the payment is a royalty, therefore, it is liable for taxation under the Income Tax Act. Therefore, as held by the Kerala High Court, the assessee has to deduct tax when the amounts were paid to the foreign company. For the very same proposition, the learned representative for the assessee placed his reliance on the judgment of the Karnataka High Court in the case of Hyderabad Industries Ltd. (supra) and decision of the http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO Hyderabad Bench of this Tribunal in the case of SOL Pharmaceuticals Ltd. (supra). The judgment of the Madras High Court in the case of Neyveli Lignite Corporation Ltd. (supra) is with regard to the payment made by the assessee under a comprehensive contract for design, manufacture, supply and erection etc. and not for any license, patent, model and design. In this case, admittedly, the license was to copy, develop and reproduce the software and market the same with trademark and logo of the foreign company, therefore, in our opinion, this judgment of the Madras High Court is also not applicable to the facts of this case.

28. Now coming to explanation to Section 191, in view of our conclusion that the payment was relatable to royalty within the meaning of Double Taxation Avoidance Agreement, irrespective of explanation to Section 191 the assessee is liable to deduct tax. Therefore, it may not be necessary for this Tribunal in this case to go into the explanation to Section 191 and find out whether it is retrospective in operation or prospective in operation.

29. Now coming to charging of interest under Section 201(IA), the contention of the assessee is that the http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO interest has to be computed from the date on which tax was deductible to the date on which tax was actually paid. Since, the tax was not deducted and tax was not paid, it is not practicable to calculate interest on the basis of provisions of Sec.201(IA). We have also carefully gone through the decision of this Tribunal in the case of Anusha Investments Ltd. (supra). There is no dispute that the charging section and computation procedure provided in the machinery provision constitute an integrated code. When the income could not be computed as per the machinery provisions provided under the Act, there cannot be any levy of tax. In this case, it is not a computation of income. It is a levy of interest for non deduction and non payment of tax. When the assessee has not deducted the tax and paid the same to the Government account, the assessee is liable to pay interest from the date on which the tax required to be deducted and the date on which the tax was actually paid to the Government account. Therefore, in our opinion, there is no difficulty in computing the interest when the assessee has not deducted the tax as provided under the Act. The person, who has not complied with the provisions of http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO Income Tax Act cannot be in a better position than a person who complied with the provisions of Income Tax Act by deducting the tax at source and paid the same to the Government account. In view of the above, we do not find any substance in the argument of the learned representative for the assessee on this issue also. In our opinion, the decision of this Tribunal in the case of Anusha Investments Ltd. (supra) may not be of any assistance to the assessee.

31. In view of the above discussion, it is not necessary to discuss the other case laws relied upon by the learned representative for the assessee. In view of the foregoing discussion, we hold that the payment of annual fee and maintenance charges are in the nature of royalty, therefore, the assessee is liable to deduct tax under Section 195 of the Income Tax Act. Accordingly, we uphold the orders of the lower authorities.

32. In the result, both the appeals filed by the assessee stands dismissed. However, there will be no order as to cost."

5. Learned counsel for the Revenue Mr.Karthik Ranganathan submitted that a Division Bench of Karnataka High Court dealt with the http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO similar controversy in the case of CIT v. Synopsis International Old Ltd. ((2012) 28 taxmann.com 162 (Kar.) and held, after detailed discussion, that such payments made by the Indian Company to the Foreign Company amounted to payment of Royalty and the Indian Company was liable to deduct tax at source on such payment of Royalty made by the Indian Company to the Foreign Company. The relevant portion of the decision of the Division Bench of the

Karnataka High Court, with which we respectfully agree, is extracted as under:-

> "45. As is clear from the description of the agreement it is an end-user software licence agreement. Clause 2.1 deals with grant of rights. It provides, Software License Synopsys hereby grants licencee a non-exclusive, nontransferable license, without right of sub-licence of use the licensed software and design techniques only in the quantity authorized by a licensee in accordance with the documentation in the use area. Licensee may make a reasonable number of copies of the licensed software for backup and/or archival purposes only. Merely because the words non-exclusive and non-transferable is used in the said licence it does not take away the software out of the definition of the copyright. The word licenced software has been defined. Similarly, the words design, design technique http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO is also defined. The word documentation is also defined and it is not in dispute what is granted is a license. Even if it is not transfer of exclusive right in the copyright, the right to use the confidential information embedded in the software in terms of the aforesaid licence makes it abundantly clear that there is transfer of certain rights which the owner of copyright possess in the said computer software/programme in respect of the copyright owned in terms of the DTAA the consideration paid for the use or right to use the said confidential information in the form of computer programme software itself constitutes royalty and attracts tax. It is not necessary that there should be a transfer of exclusive right in the copyright as contended by the assessee. The consideration paid is for rights in respect of the copyright and for the user of the confidential information embedded in the software/computer programme. Therefore it falls within the mischief of Explanation (2) of clause (vi) of subsection (1) of section 9 of the Act and there is a liability to pay the tax.
>
> 46. If there was any doubt regarding the taxability of this income the parliament by Finance Act, 2010 has substituted the explanation to section 9 which gives a clear intention of http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO the legislature insofar as the liability of tax under this provision is concerned. A perusal of the said explanation makes it clear that as there was a doubt earlier, they want to remove the doubts by introducing this explanation. By the explanation they have declared that for the purpose of section 9 which deals with income deemed to accrue or arise in India, under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not (i) the non-resident has a residence or place of business or business connection in India, (ii) the non-resident has rendered services in India. Therefore, the object is to levy tax on the income of a non-resident, if it has accrued or arisen in India and one such income is the income from royalty.
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> In the result, we pass the following:-
>
> ORDER

(a) All the appeals are allowed.

(b) Impugned orders passed by the Income Tax Appellate Tribunal, Bangalore Bench, is hereby set aside.

(c) The order passed by the Commissioner of Income Tax (Appeals) affirming the order passed by the Assistant Commissioner of Income Tax, Circle 19(1), Bangalore, with http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO modification is restored.

(d) No costs."

6. We may note here that the Karnataka High Court dealt with the case of M/s.Samsung Electronics Co. Ltd. v. ITO ((2005) 94 ITD 91 (Bang.)), which was distinguished by the learned Tribunal, in para 26 of the impugned order.

7. The learned Official Liquidator for the Assessee could not controvert the aforesaid submission of the learned Senior Standing Counsel for the Revenue.

8. Having gone through the judgment of the Karnataka High Court and the order impugned of the learned Income Tax Appellate Tribunal, we agree with the view taken by the Karnataka High Court on the issue that the payments made by the Assessee Company to the US Company for user of its Software, Logo and Trade Marks were in the nature of Royalty covered under Article 12 of the Double Tax Avoidance Agreement (DTAA) between India and USA and therefore, the Assessee, Indian Company was liable to deduct tax at source and pay the same to the State. On account of its failure to do so, it was also liable to pay interest thereon under Section 201(IA) of the Act.

9. Thus, we do not find any merit in the present Appeals filed by the Assessee and the same are liable to be dismissed and accordingly, the same are dismissed. The questions framed, as quoted above, are http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO answered against the Assessee and in favour of the Revenue. No order as to costs.

(V.K.,J.) (C.V.K.,J.) 23.4.2019 Index: Yes Internet: Yes.

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To

1. The Income Tax Officer, International Taxation II, Chennai

2. Income Tax Appellate Tribunal, Madras 'B' Bench, Chennai http://www.judis.nic.in Judgt. dt. 23.4.19 in T.C.2184/2006 M/s.Zylog Systems Limited v. ITO DR.VINEET KOTHARI, J.

and C.V.KARTHIKEYAN, J.

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