IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'B', BANGALORE

BEFORE DR. O. K. NARAYANAN, VICE PRESIDENT

AND

SHRI. SHAILENDRA KUMAR YADAV, JUDICIAL MEMBER

1. I.T.A No.985/Bang/2009
(Assessment Year : 2005-06)

2. I.T.A No.986/Bang/2009
(Assessment Year : 2005-06)

1. M/s. Velankani Mauritius Ltd.,
2. M/s. Bydesign Solutions Inc.
C/o. Chaturvedi and Shah, N-604, North Rear Wing,
Manipal Centre, Dickenson Road,
Bangalore 560 042 .. Appellants

v.

Deputy Director of Income-tax (International Taxation),
Circle - II(1), Bangalore .. Respondent

Appellants by : Shri. Arvind Sonde, Advocate
Respondent by : Smt. Preeti Garg, Commissioner of Income-tax

O R D E R

PER DR. O. K. NARAYANAN, VICE PRESIDENT :

These two appeals are filed by the assesses, for the common assessment year 2005-06. These appeals are directed against the orders of the Commissioner of Income-tax(A)-IV, at Bangalore, dated.28.8.2009 and arise out of assessment orders passed u/s.143(3) r.w.s.147 of the IT Act, 1961.

2. The assessee company M/s. Velankani Mauritius Ltd., is a company registered in Mauritius. The other company M/s. Bydesigns Inc is a company registered in USA. The assesses do not have a Permanent Establishment in India as per Article 5 of DTAA between India and Mauritius and Article 12 of DTAA between India and USA.

3. The assesses are basically involved in the supply of the software purchased from the manufacturers to the clients located in India. During the previous year relevant to the assessment year under appeal, the assesses had supplied off-the-shelf shrink-wrapped software to Infosys Technologies Ltd., (ITL) in India. The assessee did not find any reason to declare any income in India in the hands of the assesses for the reason that the software sold by the company to Indian entities were shrink-wrapped off-the-shelf software which is only the sale of copies of copyrighted articles. The assessees, therefore, assumed that the transactions did not fall within the purview of 'Royalty' as defined u/s.9(1)(vi) of the IT Act, 1961 and filed returns declaring NIL income.

4. In the income-escaping assessments, the Assessing Officer took the view that the sale of the software to Indian entities generated royalties in the hands of the assessee companies and, therefore, they are liable for taxation. He, accordingly, completed the assessment by determining

positive income by way of making additions which were confirmed in first appeals. Aggrieved, the assesses are in appeals before us.

5. The first common ground raised by both the assesses herein is that the Commissioner of Income-tax(A) has erred in confirming the action of the Assessing Officer in reopening the assessment u/s.147 r.w.s.143(3) of the IT Act, 1961. It is the case of the assesses that the reopening of the assessments u/s.147 is bad in law.

6. On merits of the issue, the common ground raised by both the assesses is that the Commissioner of Income-tax(A) has erred in confirming the action of the Assessing Officer in treating the sale of software as income from royalty chargeable under the IT Act/DTAA and thus erred in making additions for the purpose of assessments in the hands of the assesses. It is the case of the assesses that the remittances did not fall under the purview of 'Royalty' as defined u/s.9(1)(vi) of the IT Act, 1961/relevant DTAA.

7. We heard Shri. Arvind Sonde, the learned Advocate appearing for the assesses and Smt. Preeti Garg, the learned Commissioner of Income-tax, appearing for the Revenue, in great detail.

8. In fact, on a similar issue, the High Court of Karnataka had an occasion to decide over the question of applicability of Section 195 in the case of Commissioner of Income-tax and Others v. Samsumg Electronics Co. Ltd., and Others (2009) 227 CTR 335, on which decision, the Revenue has placed great reliance. In fact, the decision of the Tribunal was reversed by the Hon'ble Karnataka High Court in the above decision. But on reading through the judgement passed by the Hon'ble Karnataka High Court, we find that the Hon'ble Court has considered only the issue confining to the application of section 195 with reference to the responsibility of the assessee in deducting tax at source before making remittances to non-residents. Even though the court has held in favour of the Revenue on the application of the TDS provisions, the court has made it very clear that it has not examined the question regarding the tax liability of the non-resident assesses in respect of the payments received from the assesses in India. The court has made it clear that it was examining only the legality of the demand raised by the Revenue in terms of the provisions of Section 201 of the IT Act, 1961. An extraction from the judgement in paragraph 78 is made below :

> ***"78. For the reasons stated above, while we refrain from answering the questions raised in these appeals relating to the actual determination of the tax liability of the non-resident assesses in respect of the payments that they had received from the resident payers figuring as respondents in all these appeals***

we answer all other questions relating to the correctness or otherwise of the orders passed by the Tribunal in the negative in favour of the Revenue and against the assessee, allow the appeals, set aside the orders passed by the Tribunal and restore the orders passed by the assessing authorities and affirming orders passed by the first appellate authorities, so far as it relates to confirming the demand raised on all these respondents-assessees in terms of the provisions of s. 201 of the Act for the failure of the respondents-assessees to comply with the requirement of s.195(1) of the Act."

9. Therefore, it is to be seen that the issue raised in these cases has to be considered outside the limited scope of the judgement delivered by the Hon'ble jurisdictional High Court in the case of Samsung Electronics Co. Ltd., (227 CTR (Kar) 335).

10. A very similar issue in similar circumstances was considered by a larger bench of the ITAT, Delhi Bench 'A' (Special Bench) in the case of Motorola Inc v. Dy.CIT (2005) 95 ITD 269. After considering the nature of similar sales, the Larger Bench held that the system supplied by the assessee comprising of the hardware and the software could handle a particular number subscribers. If the number of subscribers went beyond the installed capacity, then the cellular operator had a right under the supply agreement to supply additional hardware or software. The Bench

continued to observe that handset which is supplied by the subscriber from the market contains several functions which perhaps the IT authorities had in mind when they stated that a part of the software itself was loaded to the handsets. It is common knowledge that a person may purchase any brand of handset from the market and still have access to mobile telephony which belies the belief of the IT authorities that a part of the software supplied by the assessee is loaded on to the handset with the subscriber. Thus, the cellular operator did not transfer or load any part of the software as to the SIM card or the handset of the subscriber. That established that the software supplied by the assessee to the cellular operator was installed on the hardware and no part of it was loaded on the SIM card or the handset of the subscriber. The Tribunal held that the crux of the issue was whether the payment was for a copyright or for a copyrighted article. If it was for a copyright, it should be classified as 'Royalty' both under the Income-tax Act and under the DTAA and it would be taxable in the hands of the assessee on that basis. If the payment was for a copyrighted article, then it only represented the purchase price of the article and, therefore, could not be considered as Royalty either under the IT Act or under the DTAA.

11. In the light of the rule declared by the larger bench as stated above in the case of Motorola Inc., we have to see in the present cases that a case of royalty does not arise because the payments were made for the sale of copyrighted articles.

12. The very same principle has been upheld by the Authority for Advance Rulings in the case of Airports Authority of India (2010-TIOL-19-AAR-IT), where they have held that the earnings of contract is only purchase of certain copyrighted software on outright basis and when there is no PE in India, royalty income does not arise either within the framework of Income-tax Act or under the realm of DTAA. In the present case, there is no doubt that both the assesses do not have any PE in India.

13. Exactly similar issue was considered by ITAT, Bangalore Bench in the case of Sonata Software Ltd., v. DCIT (2006) 6 SOT 700, in their order dated. 28.4.2005. Here also, software packages were brought in India for the purpose of distributing to ultimate users and imports were made from non-residents. The Tribunal held that the payments partook the character of purchase and sale of goods; and as there is no PE in

India, it could be concluded that no income accrued or deemed to accrue or arise in India.

14. The above decisions do in fact draw immense support from the judgement of the Hon'ble Supreme Court rendered in the case of Tata Consultancy Services v. State of Andhra Pradesh (271 ITR 401). In the said decision, the Apex Court has held that a software programme may consist of various commands which enable the computer to perform designated tasks. The copyright may remain with the originator of the programme, but the moment copies are made and marketed, it becomes goods which are assessable to Sales-tax. The Court continued to observe that even intellectual property once it is put to a media whether be in the form of books of canvas or computer disks or cassettes, would become "goods".

15. Therefore, in the facts and circumstances of the case, and in the light of the above binding decisions, we find that the sale of software cannot be treated as income from royalty either under the IT Act or under the terms of DTAA. Therefore, the addition made in the case of M/s. Velankani Mauritius Ltd., of Rs.1,74,60,000/- and of Rs.96,35,600/- in the case of M/s. Bydesign Solutions Inc. are hereby deleted.

16. As these appeals have been determined on the merits of the issue, we have not adjudicated the legal ground of reopening of the assessments, as it will be only academic.

17. In the result, these two appeals filed by the assesses are allowed.

Order pronounced on Monday, the 31st May, 2010, at Bangalore.

Sd/-	Sd/-
(SHAILENDRA KUMAR YADAV) JUDICIAL MEMBER	(DR. O. K. NARAYANAN) VICE PRESIDENT

MCN*
Copy to:
1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax (Appeals)
4. The CIT
5. The DR, ITAT
6. The Guard file (Bangalore)
7. The Guard file (Delhi)