IN THE INCOME TAX APPELLATE TRIBUNAL

[DELHI BENCH "**H**" DELHI]

BEFORE SHRI RAJPAL YADAV, JM & SHRI K. D. RANJAN, AM

I. T. Appeal Nos. 1331, 1332, 1333, 1334, 1335 & 1336 (Del) of 2008.

Assessment years : 1999–2000, 2000–01, 2001–02, 2002–03, 2003–04 & 2004–05.

M/s. Gracemac Corporation, C/o. S. R. Batliboi & Company, Golf View Corporate Tower B, Sector : 42, Sector Road, GURGAON - 122 002 [HARYANA].	Vs.	Asstt. Director of Income-tax, International Tax Division, Circle : 2 (1), N E W D E L H I.

P A N / G I R No. G - 249.

A N D

I. T. Appeal No. 1392 (Del) of 2005.

Assessment years : 1996–97.

M/s. Microsoft Corporation, C/o. S. R. Batliboi & Company, Second Floor, The Capital Court, LSC Phase – III, Olof Palme Marg, Munirka, N E W D E L H I–110 067.	Vs.	Asstt. Director of Income-tax, International Tax Division, Circle : 1 (2), N E W D E L H I.

P A N / G I R No. M - 308.

A N D

I. T. Appeal Nos. 1393, 1394 & 1395 (Del) of 2005.
Assessment years : 1999-2000, 2000-01 & 2001-02.

M/s Microsoft Regional Sales Corporation,		Assistant Director of Income-tax
C/o. S. R. Batliboi & Company,	Vs.	International Tax Division,
Golf View Corporate Tower B,		Circle:2(1),Sector:42, Sector Rd.
GURGAON - 122 002 [HARYANA].		N E W D E L H I.
P A N / G I R No. AADCM 1638 A.		
(Appellants)		(Respondents)

Assessee by : Shri N. Venkataraman, Sr. Adv.;
Shri Rajan Vohra, C.A.; Shri Salil Kapoor; Adv.;
Shri Mohd. Shafiq; Shri Sushant Mehta, C.A.; &
Ms. Manju, Adv.;

Department by : Shri S.G. Srivastava, Standing Counsel; &
Shri L. M. Pandey [CIT] – D.R.;

O R D E R.

PER K. D. RANJAN, AM :

These group of appeals by three different assessees arise out of separate orders of the ld. CIT (Appeals)–XXIX, New Delhi. These appeals were heard together and, for the sake of convenience, are being disposed, of by this consolidated order.

2. The appeal for assessment year 1996-97 of M/s. Microsoft Corporation in ITA No 1392 (Del) of 2005 and three appeals in ITA Nos. 1393/Del/2005 to 1395/Del/2005

for Assessment Years 1999-00 to 2001-02 of Microsoft Regional Sales Corporation(MRSC) were heard together and thereafter 6 appeals of Gracemac Corporation in I. T. Appeal Nos. 1331, 1332, 1333, 1334, 1335 & 1336 (Del) of 2008 for assessment years 1999-00 to 2004-05 were also heard. The issues involved in the appeals are common and both assessees and Revenue have requested that the arguments and submissions for all the appeals should be considered together.

3. Microsoft Corporation (MS Corp) in its return filed for AY 1996-97 offered its income from licensing of software to Original Equipment Manufacturers (OEM) to tax and did not offer to tax its income from sale of Microsoft software products to Indian Distributors. The assessing officer, however, taxed the payments received from Indian Distributors as 'royalty' under section 9(1)(vi) of Income Tax Act, 1961 and Indo-US DTAA. Against the said order MS Corp filed appeal before CIT(A) and while passing an order CIT(A) also confirmed the addition made to the income of MS Corp. Against this order assessee is in appeal before this Tribunal.

4. For AY 1999-00 to 2001-02 in case of MRSC, the payments received from Indian distributors on sale of Microsoft software products were not offered to tax as royalty. However, the assessing officer assessed the entire payments in the hands of MRSC as royalty income on the ground that payments have been received towards licensing of Microsoft software products which amounts to grant of right in Intellectual property Rights (IPRs). On appeal against the order of assessing officer, ld CIT(A) has considered that the software is being licensed and not sold and accordingly the consideration received for supply of software should be taxed as royalty. Against this order the assessee is in appeal before this Tribunal.

5. In case of Gracemac for assessment years 1999-2000 to 2004-05, the assessing officer had taxed the payments made by MO Singapore to Gracemac, USA @ 35%/40% of net sales consideration received by MRSC from Indian distributors in India under

Section 9(1)(vi)(c) of the Act and Article 12(7) (b) of the Indo- US Double Taxation Avoidance Agreement (DTAA) on the ground that Gracemac's source of royalty is MO which distributes Microsoft software products in India through MRSC and accordingly, Gracemac is getting royalty out of the licensing of Microsoft software products carried out in India. The assessing officer also held that the royalty received from MO is taxable under Article 12(7)(b) of the India US DTAA as the payment to Gracemac is based on the number of users of intellectual property rights in India. Ld CIT(A), however enhanced the assessment by bringing the entire consideration received by MRSC" from Indian distributors on the contention that MRSC and MO are legal façade. To this extent, the same revenue is being taxed in case of MRSC and Gracemac for the Assessment Years 1999-00 to 20001-02 and this according to assessee has resulted in double taxation for these Assessment Years.

6. For sake of convenience as identical issue is involved in these cases, we will take up appeal filed by assessee in the case of Gracemac Corporation in I. T. Appeal Nos. 1331 to 1336 (Del) of 2008 for Assessment years 1999–2000 to 2004–05. The grounds of appeal raised by the assessee are as under:-

> *" On the facts and in the circumstances of the case, the ld. Commissioner of Income-tax (Appeals),XXIX, Delhi ["ld. CIT (A)] has :*
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> 1. *Erred in law in determining the income of Gracemac Corporation (the Appellant") for the subject year at USD 58,764,099 completely ignoring the fact that the actual income of the Appellant from licensing of manufacturing and distribution rights to Microsoft Operations Pte Ltd. ("MO") pertaining to India was only USD 22,668,737 during the subject Assessment Year;*

2. *Erred in holding that revenue earned and received from sale of software by a group company of the Appellant – Microsoft Regional Sales Corporation, USA ("MRSC"), a distributor of Microsoft products to Indian distributors amounting to USD 58,764,099 is taxable in India in the hands of the Appellant under the provisions of the Income-tax Act, 1961 ("the Act") and the double taxation avoidance agreement between India and US ("India-US tax treaty");*
3. *Erred in observing that the Appellant has granted license to end users in India to use the Microsoft software in respect of which it earns royalty income. The ld. CIT (A) has completely ignored the fact that the Appellant only earns 'royalty' income from MO for grant of manufacturing and distribution rights in Microsoft products (which are exercised in Singapore) and which is not taxable in India under the Act or India-US tax treaty as the same is not sourced in India;*

Without prejudice to the above grounds that the Appellant has not earned income from licensing of software to end-users in India, the Appellant submits the following grounds of appeal with respect to the income from sale of software;

4. *Erred in passing the order under section 250 of the Act and taxing such income in the hands of Appellant which is otherwise also not taxable in India. In doing so the ld. CIT (A) has disregarded the decisions of the Honourable Income Tax Appellate Tribunals ("ITAT") that are squarely applicable with respect to the income for which the Appellant has been assessed and ignoring the Doctrine of Binding Precedents;*
5. *Erred on the facts and circumstances of the case and in law in concluding that the CBDT Circular No. 621/1991 and 588/1991 exempting royalty payments received in respect of 'system software'*

supplied along with computer hardware signifies that by implication, consideration for use of software products in all scenario except where the specific exemption has been granted, will be liable to tax as royalty income under section 9(1)(vi) of the Act;

6. *Erred in law in concluding that the provisions of section 115A of the Act, characterizes the income from sale of software (deemed to be income of Appellant) as 'royalty' under the Act without appreciating that section 115A of the Act applies to royalty payments as defined under section 9(1)(vi) of the Act and in the instant case, as the revenue does not amount to 'royalty' under the provisions of section 9(1)(vi) of the Act, there is no basis to rely on the provisions of section 115A of the Act;*
7. *Failed to appreciate that the sale of software is sale of 'Copyrighted Article' and not 'Copyright' in Microsoft software and accordingly, the revenue from sale of software is in the nature of business income not taxable under Article 7 of the India US tax treaty in the absence of a 'Permanent Establishment' of the Appellant in India;*
8. *Failed to comprehend the facts and has erred in law and on facts in arriving at the following conclusion :*

(a) That the Appellant has licensed software copyright to end users in India;

(b) That the source of revenue derived by the Appellant is from licensing of software and utilization / exploitation of the license granted to the users in India, completely disregarding the fact that such revenue is from sale of Microsoft products and is not in the nature of licensing revenues;

(c) That the consideration received from Indian distributors for sale of computer software is towards use of 'scientific knowledge, invention,

secret formula, process and scientific work' developed by the Appellant and hence the same is taxable as royalty under the Act;

(d) That the sale of software to Indian distributors under Volume Purchase Product ("VPP") model is akin to licensing of copyright in computer software to Original Equipment Manufactures. Accordingly, consideration received from sale of software under VPP model is taxable as royalty;

(e) That the consideration received from sale of software under Full Packaged Product ("FPP") model is taxable as royalty since the same involves granting of limited right to end users to copy the software on the hard drive of the computer.

9. Erred on the facts and circumstances of the case and in law in holding the draft report issued by High Powered Committee ("HPC") as India's position on e-commerce transaction thereby ignoring that the said report has not been accepted by the Government of India and accordingly does not have any bearing in characterization of the transaction of sale of software by the Appellant;

10. Erred in holding that the rationale laid down by the Hon'ble Supreme Court in the decision of Tata Consultancy Services Ltd. 271 ITR 401 (SC) is not applicable in the instant case;

11. Erred on the facts and circumstances of the case and in law in confirming the interest under section 234-A and 234-B of the Act while completely disregarding the provisions of the Act and the judicial precedents issued by the Hon'ble ITAT(s) and Hon'ble High Court. "

7. The key issue involved in all these appeals and is raised for adjudication before this Tribunal is as to whether the sale of "off the shelf software product" by US based non-resident companies to independent Indian distributors is taxable in the hands of such non-resident companies as royalties within the meaning of Explanation 2 to section

9(1)(vi) of the Act as well as under Article 12 of Double Taxation Avoidance Agreement between India and US.

8. The facts of the case stated in brief are that upto 31.12.1998 Microsoft Corporation (MS Corp) had directly entered into agreements with various Indian Distributors for sale of Microsoft products being "off the shelf"/ "shrink wrapped" software, on principal to principal basis. The Indian Distributors, in turn, sold these Microsoft products to re-sellers/consumers. The above business model was changed w.e.f. 1.1.1999, whereby the Microsoft products were sold by Microsoft Regional Sales Corporation [MRSC], USA, to Indian distributors, through its branch office in Singapore. The business model w.e.f. 1.1.1999 onwards in case of MRSC and Gracemac is as follows :-

i) Microsoft Corporation entered into agreement on 1/01/1999 with Gracemac Corporation, USA, a hundred per cent subsidiary, to grant an exclusive license in exchange of all shares to manufacture in the retail territory the MS retail software products including all updates as developed from time to time and to distribute such MS retail software products manufactured by its subsidiary or so manufactured by a sub-licensee or sub-contractor of subsidiary, in accordance with terms of the license agreement or the previous licenses. MS Corp also granted subsidiary, an exclusive right to license any third party in the retail territory to grant directly to customers the right to reproduce the software portion of MS retail products for internal use. The agreement also provided that all master copies provided by MS Corp to subsidiary shall at all times remain the sole property of MS Corp as shall the packaging and documentation related materials provided by MS Corp. Subsidiary also agreed not to make any copies of the master copies except as provided in the agreement and agreed to return to MS Corp. the master copies and any other materials supplied by MS Corp. immediately upon termination of the agreement. All the licenses were granted in exchange for issuance of 20 shares of subsidiary common stocks with par value of $0.01; provided that subsidiary may issue additional stock subsequent to the effective date of this agreement in exchange for any license granted under the agreement with respect of MS retail software products including updates designated by MS Corp after such date. The agreement further provided that subsidiary shall owe no other royalty or payment for any license granted under the agreement.

ii) Gracemac in turn, entered into a license agreement with Microsoft Operations Pte Ltd ("MO"), Singapore, under which MO, was granted non-exclusive license to manufacture (reproduce) Microsoft software in Singapore; non exclusive license to distribute the software products so manufactured to retailers or to MS Corp or to subsidiaries of MS Corp and non-exclusive right to license or sub-license the right to reproduce Microsoft software to certain end users (large account customers) for their internal use. In consideration to this, MO pays royalty to Gracemac for each MS retail software copy. The royalty amount ranges from 35% to 40% of net selling price received by MRSC from the distributors for the Indian Territory.

iii) MO has in turn entered into a non-exclusive distribution and inter-company services agreement (distribution agreement) with MRSC for appointing MRSC as a distributor for selling the copies of Microsoft software which are reproduced / manufactured by MO.

iv) MO sells all the software copies to MRSC in Singapore. MRSC, in turn, has entered into agreements with various distributors in various countries including India. The distributors have a right to distribute the copies of software in their respective countries.

v) The Microsoft software copies are delivered by MRSC to the Indian Distributors "Ex-warehouse" in Singapore. The distributor sells the products to the re-sellers in India which, in turn, sells them to the end users.

vi) The Microsoft Corp. entered into agreement with end users to use the software products licenced to them as per terms of agreement.

9. The modus operandi of distribution models for supply of software to Indian distributors is as under:-

a) The first model known as Fully Packaged Product (FPP) model is meant for small customers. In this model, MO, Singapore, produces the copy of software program by embedding the software in a media and sells the media containing the software through the supply chain i.e MRSC and distributors in India to the end users.

b) The other category of sale of products is called the Volume Purchased Products (VPP) model, which is for large customers like corporate customers. In this model, instead of selling individual software copies in media, the end user gets/ buys one set of media containing the software and can make as many copies for internal use as is prescribed in the license. The end user is required to pay based on the number of copies which can be made for internal use.

(c) MS Corp being the registered owner of intellectual property in Microsoft software products, entered into an 'End User License Agreement (EULA)' with the end users in India.

10.1 During the course of assessment proceedings the assessing officer noted that on 1/01/1999 Microsoft Corporation granted M/s. Gracemac Corporation, the assessee, a hundred per cent subsidiary of Microsoft Corporation, licence to manufacture and distribute all MS retail software products. Subsequently on the same date the assessee entered into another licence agreement with Microsoft Operations, a Corporation created under the laws of Singapore to manufacture and distribute Microsoft softwares in various countries including India. As per the terms of agreement the royalty was to be paid on the basis of number of copies distributed / licenced in various countries including India. Before the assessing officer there was no dispute between the Department and the assessee that the payment was covered under the term 'royalty' both as per Income-tax Act as well as Indo-US DTAA. The only objection which the assessee could raise was that income was not taxable in India as per Indo-US treaty. Further the assessing officer noted that Microsoft Operations Pte Ltd. entered into service agreement with Microsoft Sales Regional Corporation, a company registered in US an another subsidiary of Microsoft Corporation. The assessing officer noted that as per the agreement the assessee was to receive royalty of 35 to 40 per cent. Since the payment was flowing from India the assessing officer was of the view that the payments made by the end-users was in respect of royalty. The assessing officer dealt with the terms of agreement entered into between the parties. The assessing officer further noted that the assessee had granted the right to Microsoft Operations for manufacture and distribution of software in India. The assessee's source is Microsoft Operations which is distributing software in India through another group concern i.e. Microsoft Regional Sales Corporation. The agreement clearly stated that the assessee was getting royalty out of licensing of software carried out in India. The assessing officer referring to provisions of Article 12(3) of Indo-US treaty has noted that royalty and fee for included services shall be deem to arise in a contracting State when payer is a resident of that State. The assessing officer was of the view that the payment was for the right to use the copyright in the programme i.e. the software and not for manufacturing of tangible products. According to the assessing officer there was no dispute to the fact that as per Article 12(2) the royalty was to be taxed in India if it was arising in India. Since the payment of royalty was directly related to source in India and, therefore, the assessing officer treated the sale as taxable in India. As regards the contention of the assessee that commercial exploitation of right to manufacture the software was outside i.e. in Singapore, was rejected on the ground that in case of volume licences one hard disc is sent in India to customer and is granted a number of licences depending upon his requirement and he makes copies of the software in India and loads it on its computers. Therefore, the payment is related to grant of licence and the number of users of that intellectual property right for which licence has been granted. The assessing officer accordingly treated the payment as royalty arising out of licensing of the computer software. He placed reliance on the decision of Authority for Advance Ruling P. No. 13 of 1995, 228 ITR 487.

10.2 In the case of Microsoft Corporation the source of Revenue for assessment year 1996-97 was from licensing of computer software to Original Equipment Manufacture (OEM) amounting to US $ 27,16,592 and licensing of computer software to independent distributors in India amounting to US $ 1,06,11,033. The assessee accepted income from licensing of computer software to OEM as taxable, but the taxability of its income derived from licensing of software was denied. The main contention of the assessee was that what was being used in India was copyrighted article and not copyright. This contention of the assessee was rejected on the ground that software is licenced and not sold. The assessing officer referring to the Copyright Act, 1957 observed that in the case of computer programme the Copyright Act recognizes as doing or authorizing the doing of any of the acts in respect of a work or any substantial part thereof i.e. to sell or give on commercial rental or offer for sale or for commercial rental any copy of computer programme. Therefore, the assessing officer concluded that the assessee has authorized to use the copyright to Indian distributors in India. During the course of assessment the assessee placed reliance on OECD commentary. Since the assessing officer was of the view that the assessee had right over the Intellectual Property Rights [IPRs] of the software which was licenced for distribution to the end users in India the payment made for the same was in the nature of royalty. He accordingly treated the revenues from licence as income of the assessee under section 9(1)(vi) of the Act.

10.3 In the case of Microsoft Regional Sales Corporation [MRSC] the Microsoft Operations granted MRSC the right to appoint non-exclusive distributors in Asia for distribution of Microsoft software. In pursuance of such rights MRSC entered into agreements with independent distributors in India, Nepal and Bhutan for distribution of Microsoft products. It was submitted that the end users had merely been permitted to use the software and, therefore, cannot be said that he has acquired the copyright or the right to use copyright in software supplied. The end user had simply used the right to use a copyrighted article. It was also submitted that MRSC derives only sales revenue from the independent distributors and not licensing revenue. The products are delivered by MRSC to Indian distributors outside India and not taxable in India. The Revenues received by MRSC may be taxed as business profit under Article 7 of the tax treaty in the event MRSC carried on business in India through a permanent establishment [PE] in India. Since MRSC did not have PE in India its income was not taxable under Article 7 of the tax treaty. However, the assessing officer treated the payment received by MRSC by Indian distributors as royalty within the meaning of section 9(1)(vi) of the Act.

11. On appeal ld. CIT (Appeals) upheld the stand taken by the assessing officer by observing as under:-

(a) that the consideration received by the assessees in appeal is for right to use copyright in computer software as defined under section 14 of Copyright Act, 1957.

(b) that the computer software can also be covered under other Intellectual Property Rights (IPR) categories such as Patent, Process, Equipment as provided in Explanation 2 to section 9(1)(vi) and therefore by supplying software to end users, the end users have a right to use such IPRs.

(c) Computer software is separately and independently covered in the definition of 'royalty' as provided in Explanation 2 to section 9(1)(vi) of the Act. Therefore, the license of computer software is also covered under the definition of royalty.

12. Before us Sh. N Venkataraman, the Ld counsel for the assessee has submitted that clause (v) of Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 defines the royalty as the transfer of all or any rights (including the granting of a license) 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. It has been contended that the expressions *"copyright, literary, artistic or scientific work including films ……"* have neither been defined under the Income Tax Act 1961 nor the applicability of Copyright Act, 1957 has been excluded in the Income Tax Act. He has, therefore, submitted that the word "copyright" should be followed by word "of". Thus the expressions *"copyright, literary, artistic or scientific work including films ……etc."* should be read as "*copyright* ***of*** *literary, artistic or scientific work including films ……ect."*. Without adding the expression *"of"*, after the expression 'copyright', the subsequent expressions, appearing after the expression 'copyright' viz 'literary, artistic or scientific work including films and video tapes …' would be rendered superfluous or redundant. However, by adding the expression *"of"* after the expression 'copyright' in Explanation 2 to section 9(1)(vi) of Act, will thus avoid redundancy and absurdity and the real purport of the legislation, in the absence of independent definitions under the Act, can be brought out. In order to support his contention that expression "copyright" should be followed by word *"of"* he referred to provisions of section 180 of the Act wherein the Parliament has employed the expression *"of"* while dealing with a similar provision on royalties or copyright fees for literary or artistic work. He placed reliance on the decision of constitutional Bench of Hon'ble

Supreme Court in the case of Padmasundara Rao Vs State of Tamil Nadu, [2002] 255 ITR 147 wherein at page 155 it has been held that in order to avoid absurdity, provisions should be so read which results into bringing out of the correct intention of the legislation and produce a rational construction.

13. It has further been contended by ld counsel for the assessee that the contention of the ld CIT(A) that software programme should be considered as patent or invention also does not hold good. Since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer programme to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the Indian Copyright Act, 1957 and not under any other category of intellectual property right laws. Ld counsel for the assessee placed reliance on the decision of Banglore Bench in the case of Sonata Software Ltd. Vs DCIT in 103 ITD 324 for the proposition that since computer programme has been defined under the Copyright Act, 1957, it is incorrect to say that computer programme can also be considered as 'patent' / 'invention' / 'process'.

14. The next contention of the ld counsel for the assessee is that there is a difference between a "copyright" and a "copyrighted article" and in the context of software the Constitutional Bench of the Hon'ble Supreme Court in the case of Tata Consultancy Services Vs State of Andhra Pradesh (2004) 271 ITR 401 has brought out very clearly that a software programme may consist of various commands which enable the computer to perform a designated task. The copyright in the programme may remain with the originator of the programme but the moment, copies are made and marketed, it becomes 'goods' which are susceptible to sales tax. Therefore the consideration received by MRSC / MS Corp from Indian distributors is towards sale of Microsoft software products, being copyrighted articles. The end users have not been granted any right in copyright in such software and therefore, such consideration is not taxable as royalty under section 9(1)(vi) of the Act.

15. He has further submitted that the Special Bench in the case of Motorola Inc. Vs. DCIT, Non-resident circle (2005) 95 ITD 269 had also recognized the distinction between a "copyright" and a "copyrighted article". It has been observed by the Special Bench that if the payment is for 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. On the other hand if the payment is for a copyrighted article, then it only represents the purchase price of the article and therefore cannot be royalty either under the Act or under the DTAA. He placed reliance on the decision of Banglore Bench of ITAT in the case of Sonata Information Technology Limited Vs Addl. CIT 103 ITD 324. It has further been clarified that M/s Sonata Information Technology Limited is one of the distributors of Microsoft software products in India and purchases these products from MRSC for further distribution to end users. It has been held that software products distributed by MRSC were in the nature of copyrighted article and not the right to use copyright. The OECD commentary to Model Tax Convention had also approved the distinction between a "copyright" and a "copyrighted article". In view of above submissions Ld Counsel for the assessee has submitted that the end user purchasing either a Fully Packaged Products, (FPP) or a Volume Purchase Products (VPP) has only purchased copyrighted articles and has not acquired any copyright. Consequently the sale proceeds cannot be subjected to royalty. He also placed reliance on the following judgments wherein it has been held that computer software is product/goods and therefore a sale of copyrighted article gives rise to business income

- Motorola Inc. Vs. DCIT, Non-resident circle (2005) (95 ITD 269) (SB Delhi)
- Infrasoft Limited vs. ACIT, Circle 2(2) (ITA No 847 Delhi 2008) (Delhi)
- Lucent Technologies International Inc. vs DCIT (120 TTJ 929) (Delhi)
- Lotus Development Asia Pacific Limited Corporation (ITA No. 564 to 566/Del/05) (Delhi)
- Sonata Information Technology Ltd. vs DCIT (2006) (7 SOT 465)(Mum.)

- Sonata Software Ltd. vs. ITO (Int. Tax) (2006) (6 SOT 700)(Bang)
- Samsung Electronics Co. Ltd vs. ITO (TDS-1)(2005) (93 TTJ 65) (Bang)
- Hewlett – Packard (India) (P) Lt.d vs. ITO (2006) (5 SOT 660)(Bang)
- M/S Metpath Software International Limited (ITA No 179) (Delhi)

16. Further ld CIT(A) has held that the assesses have received consideration under the software license agreement for transfer of 'some rights' including the granting of license in respect of copyright in software. Further the rights which have been transferred include the right to copy software on computer hardware on a definite location and right to use software for business purpose. In case of VPP model the end user has a right to reproduce copies of software and accordingly, it is Revenue's case that the end user is granted right in copyright in software and therefore the consideration is liable to be taxed as 'royalty'. The Ld Commissioner in the order for Gracemac has noted that the Copyright Act, 1957 defines the term "copyright" to include inter-alia, the right to reproduce the work in any material form including the storing of it in any medium {section 14(a)(i) } and/ or to sell or give on commercial rental a copy of the computer programme {section 14(b)(ii)}. Ld counsel for the assessee to counter the contention of ld CIT(A) submitted that the assesses have not given any right to end users under the Copyright Act, 1957. As regards the conclusion of the ld. CIT(A) that the end user, has been granted right to reproduce a copy of software resulting in grant of the "right" covered under section 14(a)(i) of the Copyright Act, 1957 it has been submitted that making copies for back up purposes under FPP model and making copies for internal use in VPP model, would not result in exercise of the "right to reproduce" as envisaged under section 14(a)(i) of the Copyright Act, 1957 since no right of commercial exploitation has been given to the end user. In the case of FPP, the EULA permits the right to install, use and make back-up copies. A copyright is a negative right which protects the owner/ author of copyright against commercial exploitation by an unauthorized person. Section 52(1)(aa) of the Copyright Act makes it clear that making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme,

from such copies, in order to utilize the computer programme for the purpose for which it was supplied or to make backup copies, purely as a temporary protection against loss, destruction or damage, will not tantamount to 'infringement' of a copyright. In other words, installation, use, access, back-up copies will not constitute 'infringement' of a copyright. He placed reliance on the decision of Hon'ble Delhi High Court in the case of Time Warner Entertainment Company Vs RPG Netcom 2007 (34) PTC 668 (Del) (DB) wherein High Court while concluding that Copyright is a negative right has held that the object of copyright law is to prevent copying of physical material and form in the field of literature and art. It is essentially a negative right given to the author, in the sense that the Act does not confer the owner with a right to publish its work, but the right to prevent third parties from doing that which the owner is solely allowed to do under the Act. Accordingly, since the end user can only use the copy/copies of software for internal use, there is no right in copyright in software is granted to end user.

17. In short, it has been submitted that copyright is a negative right and also a bundle of rights. It deals with the right against third parties or consumers or end users. Consequently, if a statute, through a provision of law, makes it clear that the performance of any of the enumerated activities under section 52 of the Copyright Act will not constitute an infringement of a copyright, it would only mean that the third parties or customers or end users do not need a copyright to perform the enumerated activity. The force of law, through a statutory provision, protects the interest of such third parties/customers/end users. It is not a right flowing out of a contract. It is a protection flowing out of provision of law. He placed reliance on the decision of Special Bench, in the case of Motorola Vs DCIT (Supra) for the proposition that the performance of enumerated activities under section 52(1)(aa) of the Copyright Act do not result in "infringement of a copyright" and results only in the acquisition of "copyrighted articles". In view of the above, it has been submitted that assessee has only sold "copyrighted article" and has not granted any right in copyright in software to the end users.

18. Ld CIT(A) further observed that the expression "computer software" is independently covered in Explanation 2 to section 9(1)(vi) which is based on a conjoint reading of second proviso to section 9(1)(vi) of the Act, CBDT Circular No 588 and section 115A of the Act. According to him these provisions are a pointer to the legislative "intent" of first bringing software under "royalty provision" and then granting "conditional exemption" wherever necessary. Ld Commissioner (Appeals) has further held that the assessee had not sold software but has only licensed the software to the customers in India to use the same in a particular way in lieu of a consideration being licensee fee. The Ld CIT(A) has also observed that even after obtaining a copy of software, in lieu of license fee the end user further requires a permission from the assessee, to activate software on a specified machine to use the same. In view of the activation requirement, the CIT(A) had concluded that the payment made by end user is towards license to use copyright in software and not for sale of software.

19. In this regard, the ld counsel for the assessee submits that second proviso to section 9(1)(vi) of the Act should not be read, so as to bring to charge**,** that transaction, which is in the first place not covered by the provisions of section 9(1)(vi) of the Act. It has also been submitted that provisos are incorporated to establish that what is stipulated in the proviso will remain excluded from the main clause and are being highlighted more as an abundant caution. He has placed reliance on the decision of larger Bench of Hon'ble Supreme Court in the case of Commissioner of Income Tax Vs Madurai Mills Co. Ltd (1973) 89 ITR 45 wherein it has been held that it is well settled that considerations stemming from legislative history must not be allowed to override the plain words of a statute. A proviso cannot be construed an enlarging the scope of an enactment when it can be fairly and properly construed without attributing to it that effect. Further, if the language of the enacting part of the statute is plain and unambiguous and does not contain the provisions which are said to occur in it, one cannot derive those provisions by implication from a proviso. In other words, it is well settled

principle that if the language of the enacting part of the statute is plain and unambiguous and does not contain the provisions which are set to occur in it, one cannot derive those provisions by implication based on the proviso. In fact, wherever needed and whenever intended, the Parliament has employed the expression "computer software' in various places vide sections 10A and 80HHE of the Income Tax Act, 1961. The parliament could have made the intention clear by explicitly referring the term 'computer software' in clause (v) of Explanation 2 to Section 9(1)(vi) of the Income Tax Act, 1961 if intended.

20. He has further submitted that the Govt. of India, between 1996 and 2000 entered into double taxation avoidance agreements with Turkmenistan, Russia, Morocco, Trinidad and Tobago, wherein the expression "computer software" was employed independently in each of the agreements in the definition of royalty. Further in case of Double Taxation Avoidance Agreements with countries including Kyrgyz Republic entered during the period from 2001 to 2003, the term software/computer software programme has been employed in the definition of royalty. In other words, both under the Income Tax Act 1961 and in the Double Taxation Agreements entered into with various States, whenever felt appropriate the Parliament/Government has chosen to incorporate the expression "computer software" specifically. When the same is conspicuous by its absence under Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 and under Article 12(3) of the Indo - US DTAA, the same cannot be read into them by implication.

21. The provisions contained under section 115A of the Act cannot provide any aid to interpret computer software independent of 'copyright'. As section 115A is a machinery provision it cannot create charge and expression 'copyright' used in the sub-section 1(A) of section 115A is necessarily to be read with the term 'computer software'. Further, the opening phrase of sub section (1A) of section115A refers back to sub section (1) of section 115A and therefore by default, one has to fall back on Explanation (c) of section 115A (1) which again refers back to Section 9(1)(vi) read with explanation 2 to section 9(1)(vi) of the Act. It is only where a transaction is held liable to be taxable as royalty

one can proceed to prescribe the rates of taxes and where the transaction is being questioned as to whether taxable or not, reliance cannot be placed upon a machinery provision to create charge.

22. Referring to End User License Agreement (EULA) and Activation, the ld counsel for the assessee has submitted that the objective of EULA is to ensure protection against misuse, abuse or piracy of software and is nothing but a set of instructions or conditions, imposed by a copyright holder on an end user of a copyrighted article. It mandates an end user to be cautious in using the product or the copyrighted article in a manner governed by the local territory's statutory laws alongwith contractual limitations and conditions. It is similar to the restrictions and limitations imposed by a copyright owner in a book published and sold at a time when a buyer buys the book for his use. In the case of a book, the conditions and limitations form part of the published book. In the case of a copyrighted article in the nature of computer programme/software, the EULA may form part of the product or may be given as a separate printed document, along with the sale of the products.

23. Further, clause 19 of the EULA makes clear distinction between owning the copyright and selling copyrighted articles. It clearly provides that product is protected by copyright and the other intellectual property laws and treaties, and that Microsoft (or its suppliers of software code, if any) own the title, copyright and other intellectual property rights in the product. The expression '*the product is licensed not sold*' is nothing but a standard clause in the EULA and cannot vitiate or alter the status of the transaction which had happened through an entire supply-distribution channel at an arms' length. Clause 19 reasserts that copyright is never sold or handed over and the end user at no point of time should assume owning any copyright. Further the term 'Activation' is a technological mechanism meant to prevent illegal copying of the copyrighted article and consideration paid by the end user is towards acquiring the copyrighted article and not directly or indirectly for the activation. Microsoft U.S.A, the sole registered owner of the copyright

in the software, does not deal or sell copyrighted products outside the US and supply chain dealing with the copyrighted articles has nothing to do with the rights available to the owner of copyright in the software.

24. Under EULA, the end user has perpetual possession and only in case of violation of the terms of the agreement, software needs to be destroyed/returned back to MS Corp and cause 6 of the EULA makes it abundantly clear which provides that "*Pursuant to this clause, the end user has a perpetual possession of the Microsoft software product which it has legally acquired and only in a situation of violation of the terms that the end user is contractually required to destroy the product*". EULA entered between MS Corp and End users, which is more like a legal agreement/notice enlisting the terms of the usage of the software programme by the End user upon sale.

25. To conclude that since EULA states that product is licensed and not sold and there is restriction of activation of the software before the user can copy and start using the software, consideration has been received for grant of right of copyright in the software is misplaced. To understand the terms of EULA, reference can be made to notice given by a copyright owner in a book published. In case of a book, copyright owner makes a declaration that copyright in respect of the book is with the author and no part of the book to be reproduced without prior permission by the copyright owner. At a time when buyer purchases book for his use, he agrees to abide by such terms as enumerated therein. In the case of a software programme also, notice in form of EULA is given along with the software programme by the owner of the IPR wherein certain restrictions and limitation are imposed on use of software within the boundaries defined by the international laws governing such IPR's. Accordingly, user is paying for getting a copy of the software and not certain limited rights in software, which rests with the copyright owner of the software programme.

26. Ld counsel for the assessee referring the contention of the Assessing Officer / CIT(A) that the transaction should be examined under every sub-clause of Explanation 2 to section 9 (1) (vi) of the Income Tax Act, 1961 to see whether the transaction could be assessed as royalty, submits that the Assessing Officer / CIT(A) has not provided any credible basis in support of his contention and has not placed on record as to which of the sub-clauses could be invoked against the assessees to tax the impugned transaction as royalty. Even where it is accepted for argument sake that the transaction involved in the present appeals is that of licensing of the software programme to end user and only in a situation where any IPR (being copyright) is given to the end user, the transaction can be considered as falling in the definition of royalty. Computer software qualifies as a copyrighted article and the granting of license in a product does not itself qualify the transaction as amounting to royalty.

27. Referring to the contention of the ld CIT(A) that software programme should be considered as patent or invention, ld counsel for the assessee submits that such an argument does not hold good. Since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer programme to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the Indian copyright Act, 1957 and not under any other category of intellectual property right laws. The consideration received from end users/distributors is for sale of Microsoft products being copyrighted articles and no right in copyright has been granted to the end user and accordingly, the consideration received is in the nature of sales giving rise to 'business income' and not 'royalty' under section 9(1)(vi) of the Income Tax Act or Article 12 of Indo-US DTAA. Further, the business income is not taxable as the assessees are non-residents and do not have Permanent Establishment in India. Ld counsel for the assessee placed reliance on the decision of Bangalore Bench in the case of Sonata Software Ltd. Vs DCIT in 103 ITD 324 for the proposition that since computer programme has been

defined under the Copyright Act, 1957, it is incorrect to say that computer programme can also be considered as 'patent' / 'invention' / 'process'.

28. Coming to the provisions of India US DTAA, it has been submitted by ld AR of the assessee that the definition of royalty given under Article 12 should also be interpreted with reference to domestic tax laws. This is also clear from the provisions of Article 3(2) of India US DTAA which provides that for those expressions not defined under the treaty, resort can be made to the domestic laws. Further, every judicial precedent dealing with the issue involved in the present appeals has also placed reliance upon the copyright Act, 1957 to interpret the provisions of DTAA. It is also pertinent to note at this point that before the Indo-US DTAA was entered in 1990, the Copyright Act, 1957 was amended in 1984 to include within its scope "computer programme" under the definition of "literary work".

29. It is also not the case of the Revenue that pursuant to the observations of revised OECD commentary distinguishing *"copyright"* from *"copyrighted article"*, that the Government of India has chosen to incorporate the expression "Computer Software" explicitly in DTAA signed with countries post amendment in OECD commentary. For example in the case of India Saudi Arabia DTAA entered into in the year 2006, the expression "Computer Software" is conspicuous by its absence in Article 12(3) of the treaty. There is a list of other countries namely Armenia, Hungary, Ireland, Portugal, Slovenia, Sudan, Uganda, UAE where tax treaties with India were entered or revised in recent years without incorporating the expression "Computer Software" in the definition of 'royalty'. Thus there is no expressed / implied intention / policy of India to include 'computer software' in the definition of royalty.

30. On merits it has been submitted that for the years under appeal ie AY 1999-00 to 2004-05, Gracemac Corporation was assessed for the royalty income received from MO which is based on 35%-40% of the revenue received from Indian distributors on the

ground that the royalty received from MO is arising out of a 'source' in India. However, for the same years, it was subsequently held that the assessee (Gracemac) should be liable to be taxed for 100% of the revenue received by MRSC from sale of software and therefore the assessee's income was enhanced from 35%-40% to 100%. The learned CIT(A) has in the case of Gracemac examined in detail the structure followed by MS Corp for distribution of its software products in India both pre and post 1st January 1999. In his impugned order, the learned CIT(A) has concluded that after lifting the corporate veil, all the transactions between the entities involved in the distribution channel has been designed to reduce the quantum of taxable royalty. In view of ld. CIT (A) MO and MRSC being sham entities should be disregarded. Accordingly, it is a clear case of double taxation of same income as CIT(A) has on one hand has said that the Gracemac is taxable in respect of the entire payments made by end user in respect of grant of license to copy of software programme since (MRSC) is a sham entity and there is arbitrary allocation of payments made by these entities involved in the transaction. Whereas on the other hand MRSC has also been taxed for the years under appeal (i.e. A.Ys. 1999-00 to 2001-02) considering the same to be a separate independent legal entity.

31. As regards the supplies made through the supply chain ld. Counsel for the assessee has submitted that MO, Singapore, acquired the right to manufacture software products (otherwise called as 'copyrighted articles') which are sold within Singapore to MRSC and MRSC, in turn, sells them to the Indian Distributors and the Indian Distributors, in turn, sell them to the end users in India. It is also clear from the agreement that the sale by MRSC to the Indian Distributor is ex-warehouse, Singapore and the title to the property passes at Singapore. The Appellants have submitted the tax resident certificate of MRSC and MO, Singapore and a statement issued by the Ministry of trade and industry, Republic of Singapore granting certain statutory exemptions to MO. Gracemac has received 35%/40% of the payments received by MRSC, from MO, Singapore and the payments made by MO represents consideration paid towards exercise of manufacturing and distribution rights by MO in Singapore. By treating MO and

MRSC as sham entity, the Revenue is contending that there is no commercial justification for their legal existence. Thus to say that these companies are legal façade is completely extra territorial and contrary to the documents mentioned above. It, therefore, goes to prove conclusively the independent legal existence of each of the entities. Reliance has been placed on the decision of Hon'ble Gujarat High Court in the case of Arabian Express 212 ITR 31 wherein it was held that when a Sovereign State recognizes the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other Sovereign State including India to recognize the same and it is not open to Revenue to declare these entities as façade without any basis. This judgment support the proposition that MO and MRSC which are incorporated under the laws of Singapore and US having the tax residency certificate issued by authorities of their respective countries cannot be considered as fictitious entities without any legal basis. It is pertinent to note here that Revenue has never contended that the sale of software programme sold through a distribution channel have not been undertaken at arm's length price nor has challenged that transaction is a principal-principal relationship. It seems that Revenue itself is taking contradictory view to justify the taxability of Gracemac and MRSC without any valid justification for the same.

32. Revenue has argued that without prejudice to its main contention regarding taxability of payments made by end user for use the software programme as royalty, payment made by MO (35%/40%) to Gracemac is deemed to accrue or arise under the provisions of section 9(1)(vi) of the Act and under Article 12 of India US tax treaty. It has been submitted by ld counsel for the assessee that the provisions of section 9(1)(vi)(c) of the Act may be invoked on Gracemac, only if "royalty" is payable either in respect of a right used by MO for the purposes of a business carried on by MO in India or for the purposes of making or earning any income from any source in India. It has been further submitted that the royalty received from MO is not taxable in India under section 9(1)(vi)(c) of the Act for the following reasons:

(a) The issue of 'source' becomes academic or insignificant if the principle issue ie whether sale of software gives rise to royalty is decided in favour of the assessee. If the transactions are not liable to royalty, the question of source of taxation would not arise at all.

(b) The counsel for the assessee sought to argue that source of income can be at a place where either the sale takes place or the business is conducted or any income generating activity is undertaken. In the present case, since none of these activities have taken place in India, income cannot be taxed.

As in case of MO sales take place outside India the title to the products passes to MRSC outside India and MO's business of manufacturing and distribution activities are being carried out in Singapore, the payments made by MO to Gracemac are not in respect of a right used for the purposes of making or earning any income from any 'source' in India. Accordingly, the provisions of section 9(1)(vi)(c) of the Act are not attracted in this case and hence, the assessee is not taxable in India under the Act.

33. It has been also submitted that the royalty received from MO is also not taxable in India under Article 12(7)(b) of Indo-US DTAA on the ground that for taxability of royalty what is essential under Article 12(7)(b) is that the "copyright" itself should be used in India. It has already been argued at length that there is no use of 'copyright' in India by the end user and the transaction in India is in the nature of 'sale' of Copyrighted Article. Alternatively, the Revenue is entitled to invoke Article 12(7) (b) of Indo-US DTAA for imposition of tax only if MO Singapore instead of manufacturing and distributing the products (which tantamount to use of copyright) in Singapore, chooses to do so from India, in which case by virtue of the expression "use" in India would get the domain power to tax. The fact pattern clearly shows that in the assessee's case, the "use of copyright" is the "right to copy" the master copy (sublicensed by the assessee to MO). This "right to copy" the master copy is exercised by MO in Singapore and hence, "copyright" is not used in India. Consequently, Article 12(7)(b) is not attracted.

34. At the outset ld counsel for the Revenue Sh. G.C. Shrivastava has submitted that the thrust of assessee's argument is that it is a sale of copyrighted article and not the transfer of any rights in the copyright and hence the income would not fall within the meaning of royalty under the Income tax Act, 1961 or the Double Taxation Avoidance Treaty (DTAA) between India and USA. He has further submitted that the issue has to be decided in terms of the provisions of the IT Act, 1961 and under Indo-US DTAA and not under the Indian Copyright Act. The purpose of the two enactments is different - one taxes incomes and the other protects rights of the authors. Therefore, any reference to Indian Copyright Act 1957 has to be made for the limited purpose of finding out the meaning of the word 'copyright' and that too for the reason that the term 'copyright' is not defined in the Income tax Act or the DTAA. He has placed reliance on the decision of Hon'ble Supreme Court in the case of Jagatram Ahuja reported in 246 ITR 609 (SC) for the proposition that the interpretation in one statute cannot be made applicable to another statute. Paragraph 2 of Article 3 of DTAA between USA and India, to which reference was made by the Ld. Counsel assessee also stipulates the limited reference to other enactments i.e. where the terms used in the DTAA are not defined in the agreement, help can be sought from other domestic enactments.

35. He has further submitted that the term "copyrighted article" is nowhere used either in the IT Act, 1961 or the Copyright Act. The term finds its origin in U.S. Regulations and then found its way later in the OECD commentary. As recognized in the Income Tax Act as also under the Copyright Act, there are basic differences between a book or music CD and a computer programme. There is a definite rationale for keeping such a distinction. The differences can be summarized;

(i) One major attribute of a literary work is that it can be received by mind through audiovisual senses. Software, though classified as a literary work, cannot be read being in machine language. Software has to be integrated with hardware before it can be put to any use.

(ii) Book need not be copied before being used. Software cannot be put to use unless it is copied on the hard disk.

(iii) Book does not act as a process to achieve some results whereas *software* does primarily act as a process.

(iv) After acquiring a book, no further permission from the author is needed for putting it to any use (except for making copies or adaptations etc) including resale of the book but after acquiring a CD containing a software, authorizations are specifically needed for lending it to third parties and for copying it even for personal use.

Thus the term "Copyrighted Article" may be aptly used for a book or music CD but it is a misnomer in the case of computer programme (software) where one or more rights in copyright have necessarily to be transferred to make it workable. A dumb CD without right of reproduction on the hard disk is of no value to the end-user unlike a book or a music-CD.

36. The ld. Counsel for the Revenue further submits that the moot point for consideration is what the end-user is paying for? Is the payment for the material on which the programme is written or is it for the programme, which is an intellectual property? The payment is definitely for obtaining the right to copy the programme on to the hard disk and to use it. What is being used is not the CD but the programme contained in the CD, which is protected by copyright and right to copy the programme has to be exercised before it can be put to use. The nomenclature given to a transaction or to a right or a property is not decisive of the nature of the transaction or of the rights or of the property. Whether we call it a copyrighted article or a copy right, it makes no difference so long as

the consideration paid or payable by the licensee is in respect of exercising the rights in a copyright. He placed reliance on the decision of Hon'ble Gujarat High Court in the case of Ahmedabad Mfg and Calico Printing Co 139 ITR 806.

37. Ld AR for the Revenue continues his submissions by saying that the Income tax Act, 1961 maintains a clear distinction between an article and computer software. The provisions contained in Section 10A provide for deduction of such profits and gains as are derived from the export of articles or things or computer software'. The use of the word "computer software" as distinguished from articles or things is clearly suggestive of the fact that computer software is not the same as an article, whether copyrighted or not. The argument of the learned counsel for the assessee that *'computer software'* was added in Section 10A to include IT enabled services is misconceived because if that were the reason the word "article" or "thing" could have been defined to include IT enabled services. If computer software were to be regarded as articles or things which essentially mean goods or merchandise, there was no need to enact a separate Section 80HHE for granting export benefits to computer software. The deduction would have been available under Section 8OHHC itself.

38. Ld. counsel for the Revenue has also submitted that the word "copyrighted" has been defined under Law Lexicon which states that a copyright when registered becomes copyrighted. Hence, whether a computer programme is registered under the Copyright Act or not, it remains a copyright and cannot be given any other character by the mere change of noun into adjective.

39. The other limb of the assessee's argument is that it is a sale of goods. In this regard ld. Counsel for the Revenue has submitted that sale postulates transfer of ownership. When only the use or the right to use a property is given under a license there

cannot be any element of sale in the transaction. EULA clearly states that product is licensed and not sold. There are limitations on the rights granted to licensees as the programme are to be returned or destroyed on expiry of the license. Hence in the case of the assessee it cannot be considered as sale.

40. The ld counsel for the Revenue further submits that computer software, particularly Microsoft software, also falls within the ambit and scope of an "invention" and a "patent". MS Software are patented in USA. These softwares are held to be original inventions. The assessee has himself asserted in their agreements that what is being distributed by MRSC is patented software. EULA refers that the product is protected by copyright and other intellectual property rights. The arguments of the learned counsel for the assessee that computer programme are not patentable, emanates from Section 3(K) of Indian Patent Act which provides that computer programme per se or algorithms are not patentable inventions. However, as held in the case of Microsoft by US courts, some of the softwares may not be computer programmes per se but may be the original inventions and hence patentable.

41. Ld Counsel for the Revenue has further submitted that assuming for a while that computer programmes are not patentable, still these would fall in the category of inventions. There can be overlap between copyright and patent but it does not mean that both are mutually exclusive. A property may be protected both as a copyright and as a patent. In fact MS Softwares enjoy this dual protection. MS Software is also a process to achieve a certain result. Process is defined in the context of Section 9(1)(vi) to mean a series of steps to achieve a certain result. These programmes are designed to provide a certain result to the end-user. The end-user gets the right to use the process contained in the programme to achieve a desired result. The CIT (A) has relied upon the order of his predecessor in this regard. The assessee has given the right to use the patent, invention or process (each as alternative contention of the Revenue) and the consideration therefor would fall within sub-clause (iii) of Explanation 2. The expression 'use' or 'right to use' has not been defined either in the Act or in the treaty. However, this aspect has been

discussed in detail in the order of the ITAT in the case of Asia Satellite Communications Ltd and the nature of the use given in the present case squarely falls within the scope so defined. There is yet another alternative contention. If the computer software is regarded as a tangible property as contended by the assessee though Revenue is not making any such assertion, the software would still fall within the meaning of "Equipment" as appearing in sub-clause (iva) of Explanation 2 and license to use the same would still attract royalty with effect from *A.Y* 2002-03. He placed reliance on the decision of ITAT in the case of Frontline Soft Ltd —2008- TIOL-422 ITAT Hyderabad and West Asia Maritime 297 ITR 202. Therefore, it has been submitted whether we consider it under the domestic law or under the treaty, the license fee paid by the customers in India for the transfer of rights in copyright of software or for the use of the computer programmes being patent/invention/process/equipment would fall within the definition of Royalty and would be liable to tax in India.

42. He further submits that the term 'royalty' has been defined in the Explanation 2 to section 9(l)(vi) and means to include the consideration for transfer of either one or more of intellectual property rights mentioned therein. The argument of ld counsel for the assessee that sale of computer software is outside the ambit of the said Explanation is totally misplaced. Whether there is a transfer of any rights in a copyright or in other intellectual properties or not, will depend upon facts of each case and there can be no general proposition that computer software is out of purview of the said Explanation. The provisions of the Act have to be read as a whole. A composite reading of clause (vi) of Section 9(1) including second proviso to Explanation 2 leaves no room for doubt that computer software is fully covered within the meaning of 'royalty' as defined in the Explanation 2. Second proviso to section 9(1) (vi) provides for an exception from the fiction of income deemed to accrue or arise in India in respect of a computer software which is an integral part of a hardware supplied under a defined policy of the Govt. There is no reference to copyright in the proviso but only to rights in respect of computer

software. A proviso can carve out exception out of a subject matter covered in the main section. The argument of the ld. counsel for the assessee that the proviso cannot create a charge is well taken. However, in this case, there is nothing to suggest that computer software is one such intellectual property as is not covered in the Explanation. It is only by a strenuous argument of the assessee viz, that right of reproduction of one single copy in the case of FPP or of a number of copies in the case of VPP for personal or non-commercial use is not a copyright. This argument of the ld counsel for the assessee is obviously against the plain and literal meaning of the words used in Section 14(a)(i) of the Indian Copyright Act. A meaning is sought to be given to the Explanation 2 that the computer software is not covered within its scope. Such an argument suffers from different fallacies — (i) the second proviso is redundant (ii) Parliament enacted the Proviso in ignorance of what is the true scope of the Explanation-2. In the case of CIT Madras v/s Ajax Products Ltd 55 ITR 741 (SC) a 3 judge Bench of the Hon'ble Supreme Court has held that the Proviso must be construed harmoniously with the main enactment. There is another aspect of the matter. Not only the second Proviso to Section 9(l)(vi) but Section 115(1A) also refers to royalty from computer software. No rate of tax could be provided in Section 115A unless computer software gives rise to royalty income.

43. Explanation 2 defines intellectual properties in broad terms. There is nothing to suggest that if a property falls into one sub-clause, it would not fall into the other. To illustrate, an invention when registered under the Patents Act becomes a patent or else it remains only an invention. A process, when patented, becomes a patent (Process Patent), so is the case with design. Hence a property may be patent as also an invention. In the case of the assessee, the terms of the agreement clearly stipulate that the software is protected both by copyright and patent laws. The argument of the learned counsel that since computer software is specifically covered under the Copyright Act, it would not fall in any other category is fallacious. Neither the Income Tax Act nor the Copyright Act stipulates any such compartmentalization. Besides, how the rights of the authors or

inventors are protected under IP protection laws is wholly irrelevant for the purposes of deciding the issue under the IT Act. Hence, the argument of the Ld. Counsel for the assessee that Parliament has categorized 'computer software' as a literary work is of no consequence because such categorization is for IPR protection. Even unprotected IPRs are nonetheless IPRs. Computer software may have been categorized as a literary work for the purpose of copyright protection but the Income tax Act keeps a clear distinction between copyrights in a literary work like books etc and the computer software. This distinction has also been maintained under the Copyright Act by excluding computer programme from section 14(a) and enacting a separate sub-section therefore in section 14(b).

44. Section 14(a)(i) of Indian Copyright Act, 1957 defines the term "copyright" to include, inter alia, the right to reproduce the work in any material form including the storing of it in any medium. Section 14(b)(ii) takes into its ambit the activity to sell or give on commercial rental a copy of the computer programme within copyright. The meaning of the word *"reproduction"* used in section 14(a)(i) is explained in Govt. of India Publication "Handbook of Copyright Law" to mean the right to make "one or more copies". There is no contemplation that reproduction will arise only if mass copies are produced or only if these are produced for sale or commercial exploitation. The arguments to that effect do not get any support from the language employed in the enactment. It is a settled rule of interpretation that in finding out the meaning of the section, the provision should be read in its plain grammatical meaning. Nothing more is to be read. There is no room for any such intendment. Thus there being no ambiguity in the language employed in the provisions of section 14 oif the Copyright Act, import of such qualifications or limitations to the rights contemplated therein is wholly unnecessary and unjustified.

45. He has further submitted that treaties are not legislative enactments. These do not flow as acts of Parliament. Being an executive function, the words and phrases used in

the treaty are obviously the outcome of negotiations between the officials of the two contracting states. The choice of the words in the treaty are dependent upon the domestic laws of the respective countries, their understanding of the definitions appearing in Model conventions (OECD, UN, US etc), the respective commentaries and the Judicial pronouncements in their countries and elsewhere. In Indian scenario, the word "computer software" has been added at the insistence of the other parties to the negotiation, which is evident from the treaties entered into with other countries. A number of such examples were cited at the time of hearing by the ld. Counsel for the assessee. In his rejoinder, the Ld. Counsel for the appellant referred to certain treaties which Russia has entered into with other countries where computer software is not included. That position is not disputed. Some Russian treaties were cited by the Revenue only as examples to show that words in the treaty may be employed at the insistence of one or the other party and such differences should not be taken to mean change in the official position of either state by reference to what was negotiated with a third state. The treaties where Russia or any other country chose not to include computer software cannot be a guide to decide what transpired between Russia and India. The omission by Russia could be at the insistence of the third party.

46. It has further been submitted that one provision of the Act should be construed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The inconsistency or repugnancy either within a section or between two different sections or provisions of the same statute has to be avoided. This proposition gets further fortified by provisions of Section 115A(1A) which provides a rate of tax for different incomes of non residents and refers to royalty from "*copyright in any book*" or *"in respect of any computer software"*. This is a clear indication that (i) computer software is very much covered under the definition of *"royalty"* as appearing in the Act and (ii) the law treats computer software as different from copyright in any book. The suggestion of the assessee that Section 115A is only a machinery section is

totally misconceived as a section which provides the rate of tax cannot be a machinery provision. Once again a ridiculous proposition is sought to be advanced that Parliament prescribed rate of tax for an item of income not covered in the charging section (9)(1)(vi).

47. Referring to the arguments raised by ld Counsel for the assessee that EULA is signed between the end-user and Microsoft and not with the assessee, ld. Counsel for the Revenue Sh. G.C. Srivastava has submitted that Microsoft has entered into an agreement with the assessee to grant exclusive right to licence the computer softwares to customers in India and elsewhere. The said agreement, however, stipulates that while granting the license, the assessee will use the standard format and log etc. as made available by the Microsoft. Thus the terms of the agreement bind the assessee to execute the agreement with the customers in the name of Microsoft yet for all intent or purpose the right to grant license rests with the assessee and not with Microsoft. In that event the license fee received by the assessee would also not belong to Microsoft. It would only arise to assessee. The learned counsel for the assessee referred to the chart showing distribution model and sought to argue that source of none of the activities in the chain like manufacturing or marketing is in India or gives rise to income from royalty in India. This aspect may be dealt with in the case of MRSC. Revenue seeks to assert in this case that income arises not from distribution of a dumb CD, but from the grant of license in the absence of which licensee cannot reproduce copy the programme and use the same. The license has directly flowed from the assessee to the end-user in India. The consideration paid is for getting the license to copy and use the programme. Thus income from royalty arises in India.

48. The EULA being in the name of Microsoft is a consequence of agreement between Microsoft and the assessee. They have agreed not to change the format of the license agreement (EULA) or the name in which it is to be signed. The right to grant

license to the customers is given to the assessee under clause 2.1(b) of the said agreement. As stated in earlier paragraphs, the CD distributed to the customers in India is a dumb CD. It gets activated by a centralized activation system. Unless activated, it does not open. Even when the CD is activated, a license agreement has to be entered into by which the licencee gets the right to copy the programme on his hard disk and to use it. The consideration paid by the licencee is not for the medium through which the programme reaches him but for the right to have access to the programme and to use it. Thus the source of income is in India where the licence agreement is entered into. The property is being used in India to derive income from licences in India. It would, thus, squarely fall within 9(1) (vi) of the Act and Article 12(7) of Indo-US DTAA.

49. Replying to the arguments advanced by the ld. Counsel for the assessee that Article 12(7) (b) of DTAA is also not applicable for the reason that no copyright is being used in India and since the product is sold in Singapore and not in India and there is no transfer of any right in a copyright, the ld. Counsel for the Revenue has submitted that the contention with regard to the sale being in the source country or the business being conducted in the source country may be valid arguments for income under the head 'business or profession'. Income from royalty is taxable under provisions of section 9(1)(vi) of the I. T. Act and the said provision deems certain income to accrue or arise in India (which otherwise may not accrue or arise or be received in India). In the case of income from royalty u/s 9(1)(vi)(b), it accrues in India if the royalty is payable by a resident except where such payment is in respect of a right or property or information used or services utilized for the purposes of business outside India or for earning income outside India. Under section (9)(1)(vi)(c) the income from royalty will also be deemed to arise in India if it is paid by a non resident, if the right to property is used for business in India or for earning of any income from any source in India. Thus, the taxability of royalty income is directly linked to the payer and the place of utilization of the right or property. It is not in dispute that the assessing officer taxed income from royalty in respect of rights which are transferred to Indian licensees and which are being used for

earning income from sources in India. He has further submitted that the assessee transferred manufacturing, distribution and licensing rights for large account customers to Microsoft Operations for which they received royalty at the 40% of the net selling price to Indian end users. The AO taxed this amount of royalty on gross basis as provided for in section 115A of the Act and Article 12 of the Indo-US DTAA. Ld. CIT(A), however, took the view that not merely 40% of royalty but the consideration from the end users in India is liable to tax as royalty on gross basis for reason that the consideration flows from the end users for the transfer of rights to them under the agreement and the gross basis of taxation cannot be converted into net basis creating intermediate entities and reducing expenses incurred or the profits earned by them. He, therefore, enhanced the income. The AO assessed royalty income under section 9(l)(vi)(c) being the payment made by one non-resident to another non-resident while the CIT(A) has upheld and enhanced the income from royalty by invoking section 9(l)(vi)(b) the payment being from resident Indian end users. The entire consideration flows from a person who is a resident of India hence the conditions stipulated in clause(b) of Sec. 9(1)(vi) is clearly applicable The exception clause contained in Section 9(1)(vi)(b) is obviously not relevant. Without prejudice, the payment of 40% royalty made by MO to the assessee is also covered under clause-(c) of Sec. 9(l)(vi) and the necessary condition that the payer of such royalty should utilize the right or property for earning income from sources in India also stands fulfilled. Thus, looked from any perspective, the income from royalty is liable to tax in India both under the Income Tax Act and also the DTAA. Article 12(7) grants the rights of taxation to the source country when the payer is a resident of that country or where the right or property is used in that country.

50. The assessee is dealing in two kinds of products i.e. FPP and VPP. The volume Purchase Product (VPP) entails transfer of rights to the large enterprise customers for making a number of copies and not merely copies for archival purposes. The right of reproduction envisaged in Section 14(a)(i) has to be transferred to the licensees in both kinds of products. It is wholly fallacious to say that none of the copyright rights are being

transferred. It is really strange that the ld counsel for the assessee seeks to argue that in the case of VPP as well as FPP, there is no transfer of copyright right. The fact of the matter is that in the case of VPP, the licencee is allowed to make several copies depending upon the number agreed to from one copy supplied by the assessee. The right u/s 14(a)(i) are necessarily exercised in such a situation. The argument that consideration is paid for each number of copy made is totally irrelevant. It is a settled proposition of law that mode of payment and the basis of payment of consideration will not determine the nature of royalty income. He has further submitted that in the case of OEM, Microsoft Corporation had offered income from royalty to tax in India in earlier years. The moot point for consideration is not whether the licenser puts the copy of the software on the hardware and sells the hardware or not. The issue to be decided is whether the assessee has transferred any rights in the copyright as defined in Section 14 and whether has received any consideration for the same. Both such necessary ingredients are satisfied in the case of the assessee. There is no exclusivity in granting the rights to OEMs as Microsoft had granted such rights to several such manufacturers and still the income was returned as one from royalty. In fact, in the periods thereafter, a new entity of the group which is assigning such rights to OEMs in India is returning income from royalty on that basis. It is, therefore, not open to argue by drawings an artificial distinction between OEMs and other licensee (VPP & FPP) that income from the latter entities does not have the character of royalty income since the basic nature of rights transferred in either case remains the same.

51. The rights provided for in Section 14 (which protects the rights of the author) cannot be limited by the provisions of Section 52 (which protects the rights of the consumer). On the other hand, Section 52 only reinforces the view that the right of reproduction even for personal use is a copyright' or else there was no need to carve out an exception to protect the consumer. Therefore, the reference to the Copyright Act has to be made for the limited purpose for getting the meaning of the word "copyright".

Reference to other sections of the Copyright Act are wholly unnecessary and beyond the scope since the issue to be decided is not when the copyright would get violated. In the present case, the end users have neither violated the copyright nor are there any occasion for invoking the protection given under Section 52. In fact, the end-users have been granted license, as contemplated under Section 30 of the Indian Copyright Act, by an agreement to make copies. If the contentions of the assessee were correct, the agreement granting such rights was wholly unnecessary or redundant. Neither the tax laws nor the laws protecting intellectual property envisage the manner or the purpose for which these rights are to be used/ exploited. The provisions in the Income tax Act talk of transfer of rights or the use of the property but not nature of use to which the property may be put to. The use of any right in intellectual property for captive use is nonetheless a business/commercial use. In any case, the use of the property will not and cannot determine the nature and character of the rights enjoyed by the end-users or alters the nature of payment made to the licensor. Where any one of the rights mentioned in Section 14 of the Copyright Act get transferred to the licensee the payment therefor would be in the nature of royalty within the meaning of provisions of 9(1)(vi)of IT Act.

52. It has further been submitted that right of' reproduction given under the license is an element of copyright and not of sale. Referring to page 438 of assessee's paper book it has been submitted that the agreement itself states that 'grant of IPR is set forth in the agreement'. Reliance on the OECD commentary or on the IRS regulations in support of the proposition that it is a sale of copyrighted article is not valid in view of India's reservations on the OECD commentary. Reservations on the commentary imply that the views given in the commentary are not the views of Govt. of India. These reservations assume importance for the fact that OECD seeks to bring the changes in concepts of taxation by bringing changes in the commentary and not in the text of the Articles which can be done only by bilateral negotiations. The commentaries thus become ambulatory. It is not the case that when India signed the treaty with USA such views existed in the OECD commentary or that both contracting states had agreed to such a view. In that event, reservations would not be needed but when a contracting state feels that the

revised view in the commentary is not in tune with their stated original position with different contracting states, it does offer its reservation to the commentary There is neither any contradiction nor any change in the stand of Govt. of India. Though. India is not a member of OECD, yet it has chosen to state its position to remove all doubts in this regard.

53. Ld. Counsel for the Revenue further has submitted that the fallacy in the arguments of the ld. Counsel for the assessee is evident if one views his arguments in the light of provisions of section 90 of the I. T. Act. On the one hand, the Ld. counsel for the assessee seeks to argue that computer software does not give rise to royalty income as there is no transfer of rights in a copyright, while on the other he suggests India intended to tax royalty from computer software only in respect of countries where the treaty specifically stated so. Treaties are meant to grant relief from domestic taxation. If Income from a certain source is not liable to tax under domestic laws, it cannot be brought to tax by the terms of treaty. He has therefore submitted that computer software is covered under the definition of 'royalty' both under the domestic law as also the DTAA under the broad categories of IPRs like copyright, patent, invention, process or equipment. Specific items of intellectual property do not find mention either under Explanation 2 of the Act or under the definition given in Indo-US DTAA. It is submitted that when the language employed in Indo-US DTAA is not ambiguous, any reference to other treaties is wholly unnecessary. In any case, an interpretative inference by reference to comparative analysis of two different agreements is wholly unwarranted in regard to negotiated agreements. In any case, the outcome of negotiation with one country cannot lead to the presumption that similar issue was under negotiation with the other country and a contrary view has finally emerged. Such an approach would not be valid for interpreting a negotiated bilateral agreement. India US treaty was negotiated before 1990 when such views as are now expressed in the OECD commentary or elsewhere were not there. Both sides went by what was meant by the "royalty" under the law as then existing. It cannot be inferred

that computer software was meant to be excluded. Thus, going by the peculiar facts of the present case, there was a definite transfer of rights in a copyright under a license and this would give rise to income from royalty.

54. Ld. counsel for the Revenue further submitted that none of the cases relied upon by the assessee are applicable to the appeals pending before the Tribunal or have a binding precedence. To buttress his arguments it has been submitted that the Hon'ble Supreme Court in the case of CIT v/s Sun Engg. Works (P) 198 ITR 297(SC), has held that a decision of a court takes its colour from the questions involved in the case in which it is rendered and while applying the decision, the courts must carefully try to ascertain the true principles laid down by the decision and not to pick out words or sentences from the judgment, divorced from the context, to support the reasoning. It is in the above backdrop that CIT (A) has discussed the principles of sub-silentio and per in curium in his order as regards the binding nature of the decisions. The decision of a coordinate Bench or a Special Bench will not have a binding precedence unless the Bench comes to the conclusion that if the new facts brought out in the present case or the new legal submissions (not raised before or considered by earlier Benches) were before those Benches, the decisions would still not have been different. It has further been submitted that some of very vital facts and legal submissions as were not raised and/or considered by coordinate Benches in the other decisions are: (a) The clauses in the agreements, which clearly stipulate transfer of intellectual property rights. (b) The clauses in the agreements stipulating retaining of ownership in the property with the assessee and only licensing of limited rights to the licensees. (c) Effect of second proviso to section 9(1)(vi) and of section 115A. (d) Effect of distinction between 'article' and 'computer software' maintained under the IT Act. (e) India's reservations on the OECD Commentary.

55. The decision in the case of Tata Consultancy Services 271 ITR 401 was rendered under the A.P. General Sales Tax Act relying upon very broad definitions of "goods" and

"sale" appearing in the said enactment. Reference to Article *366* of the Constitution of India is also made in the same context as the Article 366 defines various terms used in the Constitution and sub- Article (12) thereof defines "goods" to "include all materials, commodities and articles". It was in the backdrop of these definitions that the Hon'ble Supreme Court held that the software, though it may contain intellectual property, would still be regarded as goods for the purposes of the said enactment. Reference made to the decision of Associated Cement Companies 4 SCC 593 was also in the same backdrop as the Customs Act also defined "goods" to include all kinds of movable property. Legislative Schemes of Sales Tax law or the Customs Act and the Income Tax Act are different. Software may be regarded as goods for the former enactments but it cannot and would not suggest that licensing of software would not give rise to income from royalty under the later enactment if transfer of rights in or use of intellectual properties is indicated. The basic difference is that while passing of rights in intellectual property is not regarded as a taxable event under the sales tax or Customs Act, it is a taxable event under the Income Tax Act. The decision in TCS itself states that the Copyright Act and the Sales Tax Act are not statutes in para materia and as such the definition contained in the former should not be applied in the latter. It was on the strength of this reasoning that the arguments of Mr. Sorabjee regarding transfer of intellectual property were rejected. By analogy, where the issue relates to the Copyright Act or the IT Act, such arguments regarding transfer of IP will assume significance. The argument of the learned counsel that these were the observations of the concurring judge, Hon'ble Justice Sinha, makes no difference to the point at issue. The AAR had the occasion to examine the decision in the context of Explanation 2 in the case of (Airports Authority of India — 304 ITR 216 and it has been held that the said decision will have no applicability in deciding the taxability of royalty income u/s 9(i)(vi) of the Act. The ld counsel for the Revenue has pointed out that the assessee seeks to rely on this decision for the proposition that there is difference between copyright and copy righted article. He submits that the decision of the Apex Court will have to be read in the context in which it was rendered. The Hon'ble Court observed "but the moment, copies are made and marketed, it becomes goods which are susceptible to sales tax". The factor of marketability or the copies of software being regarded as goods are the observations which have to be read by the qualifying words appearing at the end of the sentence viz "which are susceptible to sales tax".

56. He has further submitted that in the case of Motorola Inc (supra) the special bench has discussed the issue in Para 151 and the critical observations appear in Para 155 to the effect that the crux of the issue is whether the payments are for a 'copyright' or for a 'copyrighted article'. The final conclusion is reached in Para 104 to hold that the software supplied was a copyrighted article and not a copyright right. After analyzing the agreement, the Hon'ble Bench observes on page 426 that the *"cellular operator has been denied the right to make copies of the software except for archival back up purposes"*. However in the present case, the licensee has been given the right to make copies not only for archival purposes but also for installation of the programme on the hard disk. Para 161 records the finding that the *"software is actually a part of the hardware and it has no use or value independent of it"*. This is the vital factual distinction. In the present case, the software (computer programme) itself is licensed with the right of reproduction though for limited use. The reference to the OECD commentary in Para 165 and to IRS regulations in paras 166 to 171 will no longer be relevant in view of India's clear reservations on the OECD commentary. Even some member Countries of the OECD have also expressed their reservations on such views in the commentary. Hon'ble Bench goes on to hold, by analysis and case laws referred to in Paras 175 to 180, that the price paid for cannot be split between that for the hardware and for the software. The material facts in the present case do not call for such determination. There being no supply of hardware, the entire consideration is for the software which is an intellectual property. He, therefore submitted that the decision of the Special Bench in the case of Motorola would not apply in the light of following distinguishing features of the present case:

(a) On facts, the present case concerns the licensing of software and not of hardware embedded with software. There is no composite price paid / payable for hardware and software as in that case;

(b) On Facts, the following features of the present case were either non-existent or not raised and / or considered by the Special Bench:

(i) Clauses in the agreement clearly stipulate the transfer of rights in the intellectual property.

(ii) Clauses in the agreement retaining ownership with the assessee and only licensing of limited rights to the licensees.

(iii) End-user license agreement, which makes specific transfer of rights in a copyright.

(c) On law, the following aspects were not raised and/or considered by the Special Bench:

(i) Effect of second proviso to Section 9(1)(vi) and of Section 115(1A).

(ii) Effect of distinction between computer software and article maintained under the IT Act.

(iii) India's reservation on the OECD commentary.

(iv) The submission that reference to the Copyright Act has to be for the limited purpose of finding out the definition of “copyright”.

(v) The submission that the rights u/s 14(a)(i) do not cease to be rights by reference to Section 52 particularly when in the present case, there is no breach of copyright by the licensee so as to attract Section 52. In fact, all such rights are specifically given under the license.

(vi)The submission that rights u/s 14(a)(i) are not qualified or limited by the nature of the use of such rights by the licensee.

(vii) In view of the above, it has been submitted that the decision of the Special Bench would not be applicable to the facts of present case before the Tribunal and in view of the submissions not raised before and / or considered by the Special Bench.

57. In the case of Lotus Development Pt Ltd (supra) the reliance has been placed by ITAT on the decision in the case of TCS & Motorola. The Bench has also placed reliance on OECD **c**ommentary in Para 25, which is not warranted in the present case in the light of India's reservations.

58. In the case of Samsung Electronics (supra) ITAT has placed reliance on the decision of TCS. It has been held that what was being transferred was a copyrighted article whereas the copyright remained with the owner. Hence, the decision is not applicable to the facts of the present case, as discussed in respect of Motorola.

59. In the case of M/s. Infrasoft Limited (supra), the ITAT has placed reliance on the decision in the case of Motorola and in the case of Samsung Electronics. No other reasons have been given in this case by the ITAT to arrive at the finding. Hence, the decision is not applicable in the present case.

60. In the case of Sonata Information Technology (supra) the admitted position was that the issue was covered by the earlier decision of the ITAT. This is not so in the present case. The Bench has critically observed that the agreement with the Indian distributor did not grant any right of reproduction or distribution to the distributor. M/s. MRSC had given distribution right to the distributor was "in consequence of the exercise

of the right u/s 14(b)(ii) and not a transfer of right u/s 14(b)(ii)". He has further submitted that the decision in the case of Sonata Information Technology (supra) is not applicable for the reason that: (a) This was a case of tax deduction at source u/s 195 by Indian distributor who was the last entity in the distribution chain before the end user and the ITAT reached a finding that the distributor did not pay for any rights in the copyright. (b) The ITAT held that the payment made by the distributor was not for any rights in the copyright. The case of the Revenue in the present appeal is that since the end user is paying for rights to copy and use the software under a license directly granted by the assessee, the rights in the copyright are being transferred by the assessee. The thrust in the present case is not on the right of distribution or who enjoys that right but on the license to copy the programme (right to reproduce). The connected appeal in the case of MRSC proceeds on the basis of right of distribution (sale). In that case, the question to be considered would be whether Indian distributor is making payment for getting the right to sell the software, as contemplated under section 14(b)(ii). The fact of Microsoft Software being patented in USA and also the fact that various agreements between Microsoft and the Gracemac; Gracemac and MO and MRSC and distributors and Microsoft and EULA clearly stipulating that the programs are protected both under copyright as also patent was not brought to the notice of the Tribunal. In the light of these agreements, and the products enjoying patent protection, it is not open to argue that because of the observation of the ITAT in the case of Sonata, computer software cannot be treated as patent, invention or process etc.

61. The other decisions of the ITAT relied upon by the appellant are also distinguishable and not a binding precedence for similar reasons as these decisions primarily rely on Motorola.

62. In rejoinder the ld. counsel for the assessee clarified the position by making reference to various amendments to the Copyright Act, 1957 that the expression

'computer programme' has been granted protection under Copyright Act since 1984 and it was never intended to be covered under other IPRs. Therefore, it is incorrect on the part of the Revenue to say that the computer programme was not granted protection under Copyright Act on or before 1994. Accordingly the contention of the Revenue that computer software is independently covered in the definition of royalty deserves to be rejected.

63. As regards the contention of the Revenue that computer programme is distinct from goods or article the ld. counsel for the assessee submitted that the Parliament has employed expression "computer software" in various places vide sections 10A and 80HHC of the Act whenever it was found necessary to incorporate it specifically and not with the intention to make distinction between "computer software" and "goods" or "article". Therefore, the contention of the Revenue that expression computer software in section 10-A was never part of expressions "article" or "things" is completely misplaced and incorrect as prior to Amendment by the Finance Act, 1993 Explanation to section 10A defined produce as including word computer programme. He also submitted that the clauses of treaty should be interpreted on the plain language used and not based on what to be the intention. If the intention was to tax supply of computer software as royalty this could be done through amending Explanation 2 to section 9(1)(vi). He also submitted that the OECD Model commentary and UN model also demarcate between a "copyright" and a "copyrighted article". He placed reliance on the decision of ITAT, Calcutta in the case of Graphite India Ltd. Vs. DCIT 78 TTJ 418 (Cal). The ld. counsel for the assessee further submitted that no specific reservation has been expressed by Indian Government outlining India's own position in contrast to OECD position. Therefore, one-sided disagreement after signing the treaty is not maintainable as a contract cannot be revoked or interpreted unilaterally. Accordingly, reliance and reference to the OECD commentary is clearly permissible in law. While giving the decision of Infrasoft Limited (supra) wherein identical issue was involved the Delhi Bench has declined to accept HPC as a binding law and the foreign courts judgments relied upon by the Revenue have been

rejected on the ground that the same are not applicable to the issue involved in the present case. Referring to TRIPS agreement and WIPO Copyright Treaty the ld. counsel for the assessee submitted that additional right under section 14(b)(ii) of Copyright Act was granted to owners for commercial rentals of copies of computer software. He further submitted that term sale in section 14(b)(ii) of Copyright Act has been used merely to prevent sale of used products by end-users as in such case more than one end-user can use the same copy of software again. In the disttribution channel no commercial exploitation can be envisaged as distributor is only a medium to distribute a copy of software product to end-user (without any use, adaptation, alteration etc.). Therefore there is no commercial exploitation by the distributors. It has also been submitted that for a transaction to qualify for royalty under Explanation 2 to section 9(1)(vi) two important ingredients are required i.e. the right should be exclusive under section 14(b)(ii) of Copyright Act and (ii) for the purpose of Explanation 2 to section 9(1)(vi) the consideration must be towards grant of right in copyright. In section 14(b)(ii) of Copyright Act right to sell refers to exclusive right only whereas under distribution agreement MRSC holding a non-exclusive right to sell the products to Indian distributors for which no separate consideration has been paid to MRSC. Non-existent of both or any of the ingredients renders the provisions inapplicable to the transactions. He further submitted that Microsoft Operations is producing software copies in Singapore and are distributed through MRSC. Keeping in a wider perspective if all the agreements and supply chain obtain a right to sell i.e. MRSC, the distributors and resellers there is no price or such right to sell and the consideration flowing from the end users to MRSC are purely for supply of copy of software. MRSC has neither given any exclusive right in the software programme nor consideration received from Indian distributors towards grant of right to sell software.

64. The Revenue has distinguished decision in the case of Sonnata Information Ltd. (supra) on the ground that the judgement was given under section 195, but since the nature of payment and taxability remains the same the decision of Bangalore Bench could

not be distinguished. As regards activation code it has been submitted that activation code cannot be interpreted controlling the ownership in the copy of software sold to end users. As soon as CD containing software programme is sold to end user, such end user on payment or purchase price becomes entitled for activation and no further consideration is charged for the updates.

65. It has further been submitted the assessee has relied upon the judgment of Hon'ble Supreme Court in the case of TCS Ltd only to put forth the argument that distinction between a copyright and copyrighted articles which is a well recognized concept world over was also approved by the apex court. He fairly conceded that the decision rendered in sales tax may not have direct application in interpreting income tax provisions.

66. Commercial exploitation is an imperative requirement in order that such exploitation may be construed as 'use' of copyright. He has further submitted that in the instant supply chain, MO is the entity which is reproducing software copies in Singapore which tantamount to commercial exploitation. After, MO the supply chain involving MRSC and distributor and resellers only distributes the same copy till the time it reaches the end user. Keeping a wider perspective, even if all the elements in the supply chain obtain a right to sell i.e. MRSC, distributors and resellers, there is no price for such right to sell and the consideration flowing from end users till MRSC are purely for supply of copy of software. MRSC has neither given any "exclusive rights" in the software programme nor the consideration received from Indian Distributor is towards grant of "right to sell" software programme.

67. We have heard both the parties and gone through the material available on record. In these cases the ld CIT(A) has upheld the order of the assessing officer holding that the payments made by the end users amounts to royalties within the meaning of

section 9(1)(vi) of the Act. In brief the controversy revolves around the point whether the use of or the right to use (including the granting of licence) in respect of computer programme amounts to royalty or sale of copyrighted articles.

68. The first contention of the ld. counsel for the assessee is that the word "of" should be supplied after "copyright" and before "literary" so as to read the words "copyright, literary, artistic or scientific work……...." appearing in clause (v) of Explanation 2 of section 9(1)(vi) of the income tax Act, 1961 as " copyright of literary, artistic or scientific work………..", by applying the principle of casus omissus.

69. It is a golden rule of interpretation that the language of the statute should be read as it is. The intention of the Legislature is primarily to be gathered from the language used, which means that the attention should be paid to what has been said as also to what has not been said. As a consequence a construction which requires for its support addition or substitution of words or which results in rejection of words as meaningless has to be avoided. Hon'ble Supreme Court in Director General, Telecommunication v. T.N. Peethambaram (1986) 4 SCC 384, p. 349 has observed that it is contrary to all rules of construction to read words into an Act unless it is absolutely necessary to do so. Similarly as has been held in Union of India v. Deoki Nandan Agarwal AIR 1992 SC 96, p. 101 that the Court cannot reframe the legislation for the very good reason that it has no power to legislate. Hon'ble Supreme Court in the case of Padmasundara Rao Vs State of Tamil Nadu (supra) has held that under the first principle a casus omissus cannot be supplied by the Court except in the case of clear necessity and when reason for it is found in the four corners of the statute itself but at the same time a casus omissus should not be readily inferred and for that purpose all the parts of a statute or section must be construed together and every clause of a section should be construed with reference to the context and other clauses thereof so that the construction to be put on a particular provision makes a consistent enactment of the whole statute. This would be more so if literal construction of a particular clause leads to manifestly absurd or

anomalous results which could not have been intended by the Legislature. In view of this position of law it has to be seen whether there is any absolute need for addition of word "of" as argued by ld counsel for the assessee. Clause (v) of Explanation 2 to section 9(1)(vi) reads as under:

> "*(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*"

On plain reading of definition of 'royalty' as appearing in clause (v) of Explanation 2 of section 9(1)(vi) one will find that the legislature has used coma (,) after word "copyright". It is settled law that use of punctuation marks cannot be said as redundant. The use of punctuation mark coma (,) after word "copyright" indicates that legislative intent is to treat word "copyright" independent of words "literary, artistic or scientific work". Therefore, word "copyright" cannot be read in conjunction with words literary, artistic or scientific work by substituting punctuation mark coma (,) by word "of". Therefore, without making any tinkering to the language employed in clause (v) of Explanation 2 it reads " in a case where there is transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work etc., the consideration received by an assessee will be liable to tax as royalty. Thus none of the words such as 'literary, artistic or scientific work…' has become redundant or meaningless requiring addition of the word "of" between words 'royalty' and 'literary'; and that too by omitting the punctuation mark coma (,) after word 'copyright'.

70. Further the definition of term 'royalty' appearing in clause (v) of Explanation 2 is inclusive. Deletion of punctuation mark coma (,) and addition of word "of" between

words 'copyright' and 'literary' would limit the scope royalty only to copyright work relating to 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. The term "copyright" is wide enough to include other works such as dramatic or musical work as included in section 14(a); computer programme in section 14(b); cinematograph film in section 14(d); and a sound recording in section14(e). The acceptance of the contention of the assessee would mean that copyright in respect of above works would go out of ambit of clause (v) of Explanation 2 of section 9(1)(vi). The Legislature in its wisdom has used word "copyright" independent of subsequent words 'literary, artistic or scientific work……' by separating them by use of punctuation mark coma (,) appearing in the said clause which cannot be interpreted that there has been an omission of word 'of' on the part of the Parliament while enacting the law. It is a settled law that the need for interpretation arises when words used in the statute are, on their own terms, ambivalent and do not manifest the intention of the Legislature. It is a settled law that where the statutory word is plain and unambiguous, it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its plain meaning because they themselves consider that the consequences for doing so would be inexpedient, or even unjust or immoral. In controversial matters, there is room for differences of opinion as to what is expedient, what is just and what is morally justifiable. Parliament's opinion on these matters is permanent. The language employed in clause (v) of Explanation 2 to section 9(1)(vi) is plain, clear and unambiguous and is not capable of two meanings. Therefore, in our considered opinion there is no need for substitution of word 'of' for punctuation mark coma (,) as submitted by ld counsel for the assessee. Hence this contention of the assessee is rejected.

71. Ld Counsel for the assessee has also pleaded that the doctrine of casus omissus be applied while explaining the provisions Article 12(7)(b) of Indo –US DTAA. It has been submitted that the term "right" in article 12(7)(b) should be interpreted to mean 'Copyright' as used in the Article 12(3)(a) for harmonious construction. What is

essential under Article 12(7)(b) is that the copyright itself should be used in India. Accordingly, it has been submitted that Article 12(7)(b) should be read as under:

> *"Where the consideration for use of, any copyright is relating to the use of such copyright in India, the royalties shall be deemed to arise in India."*

This contention of the ld. Counsel for assessee cannot be accepted as it would amount to modification of Indo-US DTAA. The language of Article 12(7)(b) is clear and unambiguous. The royalties or fees for included services shall be deemed to arise in that Contracting State in which the use of, or the right to use, the right or property, or the fees for included services is performed. There is vast difference between the language used by authors of Article 12(7)(b) and proposed above by the ld counsel for the assessee as is evident from Article 12(7)(b) reproduced as under:

> *"(b) Where under sub-paragraph (a) royalties or fees for included services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for included services relate to services performed, in one of the Contracting States, the royalties or fees for included services shall be deemed to arise in that Contracting State."*

The language of clause (b) of Article 12(7) is plain, clear and unambiguous. It is not conveying two meanings. For the reasons stated in earlier paragraph this contention of the assessee deserves to be rejected.

72. Another contention of the ld. AR of the assessee is that the ld. CIT (Appeals) is wrong in concluding that the provisions of section 115A of the Act characterizes the sale of software products as royalty. It has been submitted that provisions of section 115A of the Act cannot provide any aid to interpret computer software independent of copyright.

He further submitted that section 115A is a machinery provision. It cannot create charge. The expression "copyright" used in section 115A (1A) is necessarily to be read with term "computer software". He has further submitted that opening phrase of sub-section (1A) of section 115A refers back to sub-section (1) of section 115A and, therefore, by default, one has to fall back on Explanation (c) of section 115A(1) which again refers back to Explanation (2) to section 9(1)(vi) of the Act. It is only where a transaction is held liable to be taxed as royalty one can proceed to prescribe the rate of taxes and where the transaction itself is being questioned as to whether taxable or not, reliance cannot be placed upon a machinery provision to create charge.

73. On the other hand, the ld. counsel for the Revenue submitted that one provision of the Act should be construed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The inconsistency or repugnancy either within a section or between two different sections or provisions of same statute has to be avoided. This position gets fortified by the provisions of section 115A(1A) which provides a rate of tax for different incomes of non-residents and refers to royalty from "copyright" in any book, or "in respect of any computer software". This is clear indication that (i) computer software is very much covered under the definition of "royalty" as appearing in the Act and (ii) the law treats computer software as different from copyright in any book. The suggestion of the assessee that section 115A is only a machinery section is totally misconceived as a section which provides the rate of tax cannot be a machinery provision. He further submitted that a ridiculous proposition has been sought to be advanced that Parliament prescribed rate of tax for an item of income not covered in charging section 9(1)(vi) of the Act. No rate of tax could be provided in section 115A, unless computer software gives rise to royalty income.

74. We have heard both the parties and perused the material available on record. Chapter XII of the Income tax Act, 1961 deals with determination of tax in certain special

cases. Section 115A deals with computation of tax payable on income by way of dividend, royalty and technical fees in the case of foreign companies. Section 115A(1A) provides that where the royalty payment is in respect of transfer of all or any rights (including the granting of a licence) in respect of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India, the income-tax shall be payable aggregating to amounts specified in clause (b) of section 115-A(1) of the Act. Therefore, for the purposes of computation of tax payable by the non-resident it has to be first determined that the payment is in nature of royalty in respect of transfer of all or any rights (including the granting of a licence) in respect of copyright in any book or computer software. Unless the nature of the payment is determined as per provisions of section 9(1)(vi), the provisions section 115A(1A) for the purposes of levy of income tax cannot be pressed into operation. To this extent we agree with ld. counsel for the assessee that unless nature of the payment is decided provisions of section 115A(1A) cannot be applied.

75. The next contention of the ld counsel for the assessee is that there is a difference between *"copyright"* and "*copyrighted article*" and in the context of computer software the Constitutional Bench of the Hon'ble Supreme Court in the case of Tata Consultancy Services Vs State of Andhra Pradesh (2004) 271 ITR 401 has held that the copyright in the computer programme may remain with the originator of the programme but the moment, copies are made and marketed, it becomes 'goods' which are susceptible to sales tax. Therefore, contention of the assessee is that the consideration received by MRSC / MS Corp/Gracemac from Indian distributors is towards sale of Microsoft software products, being a 'copyrighted article'. The end users have not been granted any right in copyright in such softwares and therefore, the consideration received therefore is not taxable as royalty under section 9(1)(vi) of the Act. To support this contention the ld counsel for the assessee has placed reliance on OECD commentary and decisions of various Benches of the ITAT including the decision of Special Bench in the case of Motorola Inc. Vs. DCIT (supra) wherein it has been held that if the payment is for

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. On the other hand if the payment is for a 'copyrighted article', then it only represents the purchase price of the article and therefore cannot be royalty either under the Act or under the DTAA. On the other hand, the contention of the ld. Counsel for the Revenue is that reliance on OECD commentary should not be placed at all and the issue relating to royalty be decided on the basis of provisions of Income tax Act, 1961 read with Indo-US DTAA. He has also submitted that the computer software is different from 'Article' or 'goods' and the Parliament has recognized the difference by enacting section 80-HHE for export of computer softwares. If computer software was included in the definition of 'article' or 'goods' there was no need for enacting a separate section for export of computer softwares.

76. We have heard both the parties and examined the contentions carefully. In the cases before us the taxation of payments made by end users for computer programme in the form of 'shrink wrapped' software through a distribution channel is involved. The expression 'copyrighted article' is not defined either in the Income-tax Act or in Indo-US DTAA. As per Law Lexicon the term 'copyrighted' means when a copyright is registered. As per section 2(o) of Patents Act, 1970, 'patented article' and 'patented process' means respectively an article or process in respect of which a patent is in force. However, there is no such definition in the Copyright Act, 1957 defining "copyrighted article" on the lines as has been done in the Patents Act, 1970. The term "copyrighted article" is nowhere used even under the IT Act or Indo-US DTAA. The expression 'copyrighted article' finds its origin in U.S. regulations and then found its way in the OECD commentary. In the case of Motorola the Special Bench has differentiated between 'copyright' and 'copyrighted article' by placing reliance on U.S. regulations and the OECD commentary.

77. In the case of Commissioner of Income-tax v P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460 (SC) the respondent-firm was resident of India and owning some immovable properties at Malaysia. During the course of the assessment year, the assessee earned income from rubber estates in Malaysia. The respondent also sold some property there and earned short-term capital gains. The ITO held that both the incomes were assessable in India and brought the same to tax. On appeal, the Commissioner (Appeals) held that under article 7(1) of the Agreement of Avoidance of Double Taxation entered into between Government of India and Government of Malaysia, unless the respondent had a permanent establishment of the business in India, such business income in Malaysia could not be included in the total income of the assessee and, therefore, no part of the capital gains arising to the respondent in the Malaysia could be taxed in India. On appeal, the Tribunal confirmed the order of the Commissioner (Appeals). Before Hon'ble Madras High Court, the Revenue tried to justify the levy tax by assessing officer relying on OECD commentary. While confirming the order of ITAT, Hon'ble Madras High Court rejected the application of commentaries on the Article of Model Convention of 1977 presented by the Organization for the Economic Co-operation and Development (OECD) as it would not be a safe or acceptable guide or aid for such construction.

78. Before Hon'ble Supreme Court one of the argument advanced by the Revenue was that OECD model Treaty came into existence only in the latter part of 1977, while the Treaty in question was signed in October 1976; that most of the clauses in the OECD model Treaty could not have been in the contemplation of the parties at the time when the Treaty in question was signed and the provisions of OECD model treaty cannot, therefore, be applied to the Treaty in question. In this regard Hon'ble Supreme Court while confirming the decision of Hon'ble Madras High Court in paragraph 16 rejected the contention of Revenue based on OECD commentary by holding as under:

> *"16. Taxation policy is within the power of the Government and section 90 of the Income-tax Act enables the Government to formulate its policy through treaties*

entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income-tax Act, it would be unnecessary to refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements."

79. From the decision of Hon'ble Supreme Court in the case of Commissioner of Income-tax v P.V.A.L. Kulandagan Chettiar (supra) it is clear that OECD Commentary or US IRS Regulations would not be a safe or acceptable guide or aid for interpretation of provisions of Income tax Act, 1961 or Double Taxation Avoidance Agreement between India or other country. During the course of arguments the ld. Counsel for the assessee has not brought out anything to suggest that the language used in Explanation 2 to section 9(1)(vi) or Article 12(3) of the treaty defining the term "royalty" is ambiguous. In fact the words "copyrighted article" do not find any mention in the Act or in the Treaty or even the Copyright Act, 1957. Respectfully following the decision of Hon'ble Supreme Court in the case of P.V.A.L. Kulandagan Chettiar (supra) it is held that for the purposes of interpretation of term 'royalty' in respect of computer software reliance cannot be placed on difference made in OECD Commentary or in the US Regulations between expressions "the transfer of a copyright right" and "the transfer of a copyrighted article". The of royalty in respect of computer software has to be decided on the basis of provisions of the Income Tax Act and Indo-US DTAA.

80. Further, Hon'ble Supreme Court in the case of TCS Ltd (supra) observed that in case of a computer software programme which consists of various commands in order to enable the computer to perform a legitimistic task. The copyright in the programme remains with the originator. The moment copies are made and marketed, it becomes goods which are susceptible to Sales-tax. This decision was rendered by Hon'ble Supreme Court under Sales Tax Act. The ld. AR of the assessee had fairly conceded that the decision is not applicable to Income-tax proceedings but it will be relevant while deciding the issue of royalty in respect of computer software programmes as Hon'ble

Supreme Court has made distinction between 'copyright' and 'copyrighted article'. In this connection we would like to say that the copies made from master copies of computer programme cannot be used by the users without obtaining activation code which is given on signing of agreement known as EULA. Therefore, it cannot be said that the consideration received by the assessee was in respect of computer programme recorded on CD. It consists of the cost of the CD, the cost of recording the programme on it and the cost of licence granted to by the user on signing of the agreement. The Authority for Advance Ruling [AAR] in the case of Airport Authority of India 304 ITR 216 has observed that the issue of transfer of right to use the goods did not come up for consideration in that case. While holding that the decision of Hon'ble Supreme Court in the case of Tata Consultancy Services Vs. State of Andhra Pradesh (supra) was not applicable to Income-tax the AAR has observed as under :-

> " 20 ……….It may be mentioned that the legislative scheme of Sales tax law and Income-tax law are very different. While the object of the Sales tax law is to tax transactions of sale of movable properties, Income-tax law is concerned with taxing incomes and profits of individuals, companies and other entities in whatever manner earned………. Delivery of goods on hire purchase and transfer of right to use goods are deemed under this branch of law as amounting to same. There is no provision with regard to royalty under the Sales tax law. As could be seen from Tata Consultancy's case (2004) 271 ITR 401 (SC), the court has treated the disc / floppy containing the software as goods, whose value has been greatly enhanced because of the intellectual property input incorporated in it. Passing off the right to use intellectual property as such has not been regarded as a taxable event. On the other hand, under the Income-tax Act as well as the DTAA the payment made in lieu of transfer of right to use copyright is a royalty income. The transfer of disc / floppy on which the copyrighted software has been inscribed is immaterial for this purpose."

From the decision of AAR it is clear that the issue of royalty was not before the Hon'ble Supreme Court nor was it required to be adjudicated upon in the Sales-tax provisions. Therefore, the decision of Hon'ble Supreme Court in the case of TCS Ltd. (supra) cannot be applied to the facts of the assessee's case. It is a settled law as held by Hon'ble Supreme Court in the case of Sun Engineering Works Pvt Ltd.(supra) wherein it has been held that *"it is neither desirable nor permissible to pick out a word or a sentence from the judgment of this court, divorced from the context of the question under consideration and treat it to be the complete " law " declared by this court. The judgment must be read as a whole and the observations from the judgment have to be considered in the light of the questions which were before this court. A decision of this court takes its colour from the questions involved in the case in which it is rendered and, while applying the decision to a later case, the courts must carefully try to ascertain the true principle laid down by the decision of this court and not to pick out words or sentences from the judgment, divorced from the context of the questions under consideration by this court, to support their reasonings."*. In the case of TCS Ltd (supra) Hon'ble Supreme has decided the issue in the context of sales tax. Passing off the right to use intellectual property as such has not been regarded as a taxable event by Hon'ble Supreme Court.

81. Hon'ble Supreme Court in the case of R. C. Anand Vs. Deluxe Films AIR 1978 SC 1613 at page 1617 observed as under :-

> " There can be no copyright in an idea, subject-matter, themes, plots, or historical or legendary facts, and violation of the copyright in such cases is confined to the form, manner and arrangement and expression of the idea by the author of the ***copyrighted work***. Where same idea is being developed in a different manner, it is manifest that the source being common, similarities are bound to occur. In such a case the Courts should determine whether or not the similarities are on the fundamental or substantial aspects of the mode of expression adopted in the ***copyrighted***

> ***work.*** If the defendants work is nothing, but a literal imitation of the ***copyrighted work*** with some variations here and there it would amount to violation of the copyright. In other words, in order to be actionable the copy must be substantial and material one which at once leads to conclusion that the defendant is guilty of an act of piracy………. "

On a careful reading of the decision of Hon'ble Supreme Court in the case of R. C. Anand Vs. Deluxe Films (supra) above, one would infer that Hon'ble Court has used expression 'copyrighted work' with reference to a work in which a copyright subsists.

82. Before we embark upon any enquiry with respect to construction of Clause (v) of Explanation (2) to section 9(1)(vi), we have to keep in mind certain basic principles of interpretation of statutes. It is settled law that that the words of a statute are first understood in their natural, ordinary or popular sense and phases and sentences are construed according to their grammatical meaning unless that leads to some absurdity or unless there is some thing in the context, or in the object of the statute to suggest the contrary. In a case if the language of the statute is not clear and there is need to resort to aids of construction, such aids can be either internal or external. Internal aids of constructions are definitions, exceptions, explanations, fictions, deeming provisions, headings, marginal notes, preamble, provisos, punctuations, saving clauses, *non obstante* clauses, etc. The external aids are dictionaries, earlier Acts, history of legislation, parliamentary history, parliamentary proceedings, state of law as it existed when the law was passed, the mischief sought to be suppressed and the remedy sought to be advanced by the Act. There is no ambiguity in the definition of term "royalty" as appearing in Explanation 2 to section 9(1)(vi) of the Act or article 12(3) of Indo-US DTAA and therefore, there is no need for importing the expression " Copyrighted Article" from OECD Commentary or US guidelines for the purposes interpretation of term "royalty" Hence for the purposes of income tax a copyrighted article cannot be treated as product.

83. U/s 9(1)(vi) of Income tax Act,1961 income by way of royalty shall be deemed accrue or arise in India:

(i) royalty payable by the Central Government or any State Government;

(ii) royalty payable by a resident, except where the payment is relatable to a business or profession carried on by him outside India or to any other source of his income outside India; and

(iii) royalty payable by a non-resident if the payment is relatable to a business or profession carried on by him in India or to any other source of his income in India.

84. Explanation 2 to clause (vi) of section 9(1) which defines the term "royalty" is wide enough to cover both industrial royalties as well as copyright royalties. It reads as under:

> *"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 trade mark 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 trade mark or similar property ;*
>
> *(iii) the use of any patent, invention, model, design, secret formula or process or trade mark 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(iv), (iva) and (v)."

85. The term "royalty" takes into its ambit the industrial and copyright royalties. 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 first category the rights are purchased which enable use of those rights, while in the second category, no purchase is involved, only 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 bundle of rights, all of which are rights in rem, being good against the entire world and not merely against a specific person and such rights are indeterminate in duration and residuary in character as held by Hon'ble Supreme Court in the case of Swadeshi Ranjan Sinha Vs. Hardev Banerjee AIR 1992 SC 1590. When rights in respect of a property are transferred and not the rights in the property, there is no transfer of the rights in rem 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 and residuary in character. Lump sum consideration is not decisive of the matter. That sum may be agreed for the transfer of one right, two rights and so on all the rights but not the ownership. Thus, the definition of term royalty in

respect of the copyright, literary, artistic or scientific work, patent, invention, process etc. does not extend to the outright purchase of the right to use an asset. In case of royalty the ownership on the property or right remains with owner and the transferee is permitted to use the right in respect of such property. 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. In an outright transfer to be treated as sale of property as opposed to licence, alienation of all rights in the property is necessary.

86. In View of above discussion we have to now examine the true nature of the transaction involved in these appeals. In brief the contentions of the ld. counsel for the assessee are that since computer programme is protected under the Copyright Act, the reliance should be placed on Copyright Act only and not on other Intellectual Property Rights laws. The ld. counsel for the assessee has stated that in order to constitute a copyright there should be commercial production. The act of reproduction as envisaged in section 14(a) of the Copy-right Act, 1957 is a right to exploit the copyright commercially whereas the expression used in section 52(1)(aa) of the Copyright Act is the making of copies by lawful possessor of a copy is not infringement of copyright right. According to the ld. counsel for the assessee the installation and storage on hard disc of computer programme is not a copy right. On the other hand, the ld. counsel for the Revenue has submitted that section 14(a)(i) of the Indian Copy-right Act, 1957 defines the term “copyright” to include inter-alia the right to reproduce the work in any material form including the storing of it in any medium. Section 14(b)(ii) takes the activity to sell or give on commercial rental a copy of computer programme within the ambit of copyright. He has referred to Government of India Publication "Hand book of Copyright Laws" according to which copyright means the right to make one or more copies. Therefore, according to the ld. counsel for the Revenue there is no contemplation that reproduction will arise only mass copies are produced or only if these are produced for sale or commercial exploitation.

87. We have considered the submissions made by both the parties. The word "copyright" is neither defined under Income-tax Act nor under Double Taxation Avoidance Agreement. Section 14 of the Copyright Act, 1957 defines the term "copyright". Clauses (a) and (b) of section 14 of the Copyright Act, 1957 which are relevant for deciding of the issue are extracted as below:

"14. Meaning of copyright - For the purposes 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 (i) 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;

PROIDED that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental."

88. Under section 14 (a) of the Copyright Act, 1957 the owner of the copyright in a literary, dramatic or musical work has the "exclusive right" to do the acts such as to reproduce the work in any material form including the storing of it in any medium by electronic means; to issue copies of the work to the public; to perform the work in public, or communicate it to the public; to make any cinematograph film or sound recording in respect of the work; to make any translation of the work; to make any adaptation of the work etc. Any person doing any of these acts without licence, consent or authorization of the owner will be committing an infringement of these rights. Section 14(b) of the Copyright Act, provides that the owner of copyright in computer programme has "exclusive right" to do any of the acts specified in clause (a); sell or give on commercial rental, or offer for sale or hire for commercial rental any copy of computer programme. Thus the expression "exclusive right" used in section 14(a) or section 14(b) of the Copyright Act refers to the rights of author/creator and not the "exclusive right" to be given by him to some party to reproduce the copyrighted work or sell the computer programme etc. It also does not mean that non-exclusive right given by the owner of the copyright to some other party to do one or more acts will not have copyright in respect of the property. Even grant of one right in respect of a copyright or work would amount transfer or the use of copyright. Section 30 of the Copyright Act, 1957 empowers the owner of the copyright in any existing work or in future work to grant any interest in the right by licence in writing signed by him or by his duly authorised agent. Therefore, for the purposes of a licence there is no requirement in Copyright law that the author should grant exclusive right to other person to do all or any of the acts to which the author is having exclusive rights. The expression 'reproduce' used in section 14(a)(i) is explained in Govt. of India Publication "Handbook of Copyright Law" to mean the right to make "one or more copies". There is no contemplation that reproduction will arise only if mass copies are produced or only if these are produced for sale or commercial exploitation. We are not dealing with an issue whether or not; there is any infringement of copyright for which reference to section 51 or section 52 of the Copyright act, 1957 should be made. The issue of royalty is to be decided as provisions of Income tax Act and Indo-US

DTAA. We can only refer to the provisions of the Copyright Act for limited purposes of definition of term “copyright”.

89. Section 2(ffc) of the Copyright Act defines the expression “Computer programme” as 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. Software is usually developed in three stages. First, a System Analyst or Designer prepares a specification, which normally includes data flow setting out the basic logic of programme. Then a source code programme is written in either a higher level computer language (e.g. oracle, or visual basic) for the ease of development or lower level language (e.g. C, C+, C++ or visual C) or power explicit control output. However, in either case, the source code cannot be read directly by a computer. The source code is converted by an assembler or complier programme into object code. Object code is essentially a form of source code which can be read or acted upon by micro-processor or central processor unit (CPU) of computer. Object code is an expression in binary notation consisting of the series of ones and zeros, (reflecting electrically, 'on' and off states) which are understood by a particular computer. The object code, therefore, is a replication of source code in a different form. 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 adaptation or mechanical translation of the source code entitled to copyright protection. Authorship of both the source code and the object code are protected by the copyright Act as literary work. Further section 2(ffc) of Copyright Act, 1957 defines "computer programme" and 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 to achieve a particular result. As per section 2(o) of the Copyright Act, literary work includes computer programme, table and compilations including data basis. Thus from the combined reading of sections 2(ffc) and 2(o) of the Copyright Act, it is clear that "computer programme" is a literary work.

Because of the above reasons a computer programme has been treated as literary and and the author has been granted protection under the Copyright Act, 1957. Since the computer programme has been considered as a literary work in order to protect the interests of the author under the copyright Act, it would be incorrect and illogical to interpret the income tax provisions relating to royalties based on the Copyright Act. Whether a consideration is in nature of royalty or not reference has to be made to provisions of Income tax Act and Indo-US DTAA. But since the computer programme is a literary work within the meaning of 2(ffc) and 2(o) of the copyright Act, the consideration received will be in nature of royalty if it is in respect of the transfer of all or any rights (including the granting of a licence) in respect of the same under clause (v) of Explanation 2 of section 9(1)(vi) of the Act.

90. There is nothing either in the Income tax Act or Indo-US DTAA that once a case falls in one of the clauses of Explanation 2 of section 9(1)(vi) it cannot be considered in any other clause. Moreover the plain reading of definition of royalty as contained in Explanation 2 to section 9(1)(vi) and Article 12(3) of Indo-US DTAA it is evident that the definition takes into its ambit both the industrial as well as copyright royalties. When provisions of section 9(1)(vi) of Income Tax and Indo-US DTAA are applicable in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property, any copyright, literary, artistic or scientific work etc. and relief under Indo-US DTAA has been provided in respect of income chargeable to tax under Income tax Act, it will not be appropriate to restrict the scope of definition of term royalty under Income tax law only on the ground that since computer programme has been provided protection under copyright Act, the provisions of other IPR laws will not be applicable. We, therefore, are not in agreement with the arguments ld. Counsel for the assessee that other IPR laws with reference to the definition of term “royalty” will not be applicable to the case of the assessee.

91. There is no dispute that the Microsoft products are patented in USA which is evident from Clause 4.1 of the Parent Subsidiary agreement between MS Corp and Gracemac stating that the software is protected both by copyright and patent laws. EULA also refers that the product is protected by copyright and other intellectual property rights. There can be overlap between copyright and patent. Both are mutually exclusive. Indian Patent Act, 1970 differentiates patentable and non-patentable inventions. Under section 2(m) of the Patent Act, 1970 defines a patent to mean a patent for any invention granted under the Act. Clause (iii) of Explanation 2 of section 9(1)(vi) defines royalty as consideration for the use of any patent, invention, model, design, secret formula or process or trade mark or similar property. Therefore, the payments made by the end users as a consideration for the use or the right to use of such patents will be in nature of royalty. Hence the case is covered by the clause (iii) of section 9(1)(vi) of IT Act, 1961 and also by the definition of term "royalty" appearing in Article 12(3) of Indo-US DTAA.

92. The Revenue has also contended that the right to use a process is also covered under the definition of royalty and computer programme is nothing but a set of instructions designed to provide a certain result to end users and thus payments made for use of computer programme involving a process would result in giving arise to 'royalty' payments under Explanation 2(ii)/(iii) of Section 9(1)(vi) of Act. Reliance has been placed on New Oxford Dictionary wherein the meaning assigned to the word 'process' is "series of action or steps taken in order to achieve a particular end". To provide a clear understanding of the term 'use' or 'right to use' a process, reliance is placed upon the judgment of ITAT given in the case of Asia Satellite Communications Ltd. (85 ITD 478) wherein it was held that assessee derived benefit by utilizing the process in the transponder facilitating rely of their programme to the viewers and process involved in the transponder was used by the assessee for carrying on their business.

93. Ld Counsel for the assessee in rejoinder has submitted that since the Parliament has chosen to classify computer programs as literary work under section 2(o) of the

Copyright Act, the other category of the IPR's which are patent, invention, secret formula or process will not operate. However, even if computer software is to be considered as falling under process, the term 'process' has to be interpreted as an intellectual property right rather than as being interpreted in the ordinary sense. Reliance is placed on the following judicial precedents:

- *Philips NV v. Commissioner of Income-tax 172 ITR 521 (Calcutta);*
- *DCM Ltd v. Income-tax Officer 29 ITD 123 (Delhi ITAT); and*
- *Modern Threads (I) Ltd v. Deputy Commissioner of Income-tax 69 ITD 115 (TM) (Jaipur ITAT).*

He has further submitted that the expression "process" appearing in Explanation 2(ii) to section 9(1)(vi) of the Act cannot be invoked as consideration paid by the end user is towards the product and not towards the working of a process. It has been submitted that the decision given by the Delhi bench of ITAT in case of Asia Satellite Telecommunications Co. Ltd vs DCIT (Supra) was on entirely different facts where payments were made towards use of transponder capacity and not towards purchase of any product. He placed reliance on the decision of the Bangalore Bench in the case of Sonata Software Ltd. Vs DCIT (Supra) wherein it has been held that "computer programme" being specifically covered under copyright, it cannot be again said to be covered under the "process".

94. We have considered the arguments advanced by both the parties. As per Wikipedia dictionary in computing, a process is instance of a computer programme that is being executed. It contains the programme code and its current activity. Depending on the operating system (OS), a process may be made up of multiple threads of execution that execute instructions concurrently. Thus computer programme is a passive collection of instructions; a process is the actual execution of those instructions. Several processes may be associated with the same programme; for example, opening up several instances

of the same programme often means more than one process is being executed. In CIT Vs. Datacons P. Ltd. 155 ITR 66 (Kar.) the company was engaged in processing the data supplied by its customers by using IBM unit record machine computer. The assessee received vouchers and statements of accounts from its customers and converted them into balance sheets, stock accounts, sales analyses etc. They were printed as per the requirement of the customers. Hon'ble Karnataka High Court held that in all those activities the assessee had to play an active role by coordinating the activities and collecting the information. Such activities amounted to processing of goods. In the case of Asia Satellite Telecommunications Co. Ltd Vs DCIT (Supra) it was held that the assessee was deriving income from lease of transponder capacity of its satellites. The assessee was amplifying and relaying the signals in the footprint area after having been linked up by the TV channels. The essence of the agreement of the TV channels with the assessee was to relay their programmes in India. The responsibility of the assessee was to make available programmes of the TV channels in India through transponders on its satellite. The function of the satellite in the transmission change was to receive the modulator carrier that earth stations emitted as up-linking, amplifying them and retransmitting them and down-link for reception at the destination earth stations. The meaning of the word "process" being a series of action or steps taken in order to achieve a particular end, considering the role of the assessee in the light of meaning of the term 'process', it was evident that the particular end, namely, viewership by the public at large was achieved only through the series of steps taken by receiving the up-linked signals, amplifying them and relaying them after changing the frequency in the foot-print area including India. It was held that the TV channels in entire cycle of relaying the programmes in India were using the process provided by the assessee and, therefore, it was liable to be taxed as royalty income. In NV Philips Vs. CIT (supra) the assessee received the amount for providing specialize knowledge of manufacturing particular commodity which included working methods, manufacturing processes including indications, instructions, specifications, standards and formulae, method of analysis and quality control. It was held that the payment for the user of such specialized knowledge, though not protected by a patent, was assessable as royalty. This decision supports the cause of Revenue and the assessee. Similarly in the case of DCM Ltd. Vs. Income-tax Officer (supra) the issue related to transfer of comprehensive technical information, know-how and supply of equipment. It was held that the collaboration agreement dealing with the dispatch of one or more of its engineers, technologists to visit the factory site of the assessee, train the factory personnel and to commission the specified processes, would not create a permanent establishment. Therefore, it was held that the payments were not in the nature of royalty. The facts of the case before us are entirely different and, therefore, distinguishable on facts and the assessee cannot derive any benefit from the decision of this case. In the case of Modern Threads (I) Ltd. Vs. DCIT (supra) it was held that the payments were made in installments to Italian company for supply of technical know-how and also for supply of basic process engineering documentation for designing, construction and operation of plant subject to their liability on account of rectifying form, it was held that the amount paid for supply of technical know-how and basic engineering documentation for setting of the plant in India for manufacturing of PTA was the business profit in the hands of Italian company in the absence of permanent establishment in India. Therefore, the facts of this case are also different. The payments did not fall within the term 'royalty' as defined in Article 13(3) of DTAA between India and Italy. Therefore, the facts of this case are also distinguishable.

95. From above discussion it clear that computer programme is a process when it executes instructions lying in it in passive state. Therefore, any consideration made for the use of process would amount to royalty.

96. Coming to the question whether computer software/programme is an invention, the ld counsel for the assessee submits that since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer program to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the

Indian copyright Act, 1957 and not under any other category of intellectual property right laws. On the contrary the contention of Revenue is that computer software, particularly Microsoft software products also fall within the ambit and scope of an "invention" and a "patent".

97. There is no dispute that MS Softwares are patented in USA and find mention in the parent subsidiary agreements. No doubt the computer software are provided protection under copyright Act as literary work, it does not mean that the computer programme will not be an invention. These softwares are held to be original inventions. The assessee has himself asserted in their agreements that what is being distributed by MRSC is patented software. EULA refers that the product is protected by copyright and other intellectual property rights. Even though as per section 3(k) of the Patent Act, 1970 a computer programme per se other than its technical application to industry or a combination with hardware, is not invention to be patented but the fact remains that Microsoft programmes being patented are inventions. In section 9(1)(vi) a patent and an invention are two different items. Under section 2(m) of the Patent Act, 1970 defines a patent to mean a patent for any invention granted under the Act. Hence we are in agreement with the arguments of ld. counsel for the Revenue that Microsoft computer programmes are inventions and the payment made for the use or the right to use the same would amount to royalty.

98. Another contention of Ld Counsel for the Revenue is that when the computer software embedded in CD is considered as tangible property then transaction should be examined under explanation 2(iva) for *"the use or right to use any industrial, commercial or scientific equipment .."* and reliance was placed on the decision of Chennai Bench of ITAT in the case of West Asia Maritime Ltd. vs ITO reported in 297 ITR 202 wherein it was held that equipment would include every kind of fixed assets and ship whether or not specifically mentioned under Explanation 2 to section 9(1)(vi) of the Act will be covered by the expression "equipment". Ld counsel for the assessee on the other hand had

submitted that the expression “equipment” used in the Explanation 2 to section 9(1)(vi) of the Act cannot be interpreted to be wide enough to cover within its ambit even a computer software . The decision of Chennai Bench of ITAT in case of West Asia Maritime Ltd. vs ITO (297 ITR 202) is not applicable to the present case as is distinguishable on facts involved in the present appeals. The reliance placed by Revenue on the decision of Hyderabad Bench of ITAT in case of Frontline Software Ltd Vs. DCIT - ITA No. 1080 to 1082/Hyd./2003, is misplaced as Chennai Bench did not rendered its decision on the issue whether right to use a computer software will mean usage of an ‘industrial, commercial or scientific equipment’, rather the issue on hand was whether based on the facts of the case transaction involved was that of an absolute assignment of ownership or transfer of right to use. We have considered the arguments advanced by parties. There is no dispute that computer programme is not a tangible property. Moreover we have rejected the contention of assessee that computer programme embedded in CD are not “copyrighted articles” and therefore there is no need to decide the issue whether an intangible property will be in nature of equipment. The plea raised by Revenue is an alternate plea and that too in situation when computer programme in a CD was to be considered as a “copyrighted article”.

99. The owner of a copyright may grant an interest in the copyright by a licence. The licence may be confined to one or more interests or to the entire copyright. A licence is an authorization of an act which without such authorization would be an infringement. In the case of a licence the licencee gets the right to exercise particular right subject to the condition of the licence, but does not become the owner of that right whereas an assignee becomes the owner of the interest assigned. In the case of a sale the purchaser becomes the owner of the property and acquires the right to sell, lease, licence etc. In order to decide the nature of the transaction in the present appeals it is important to refer to various clauses of End User Licence Agreement. EULA contains the following warning **"important - read carefully"** which is reproduced as below:

> *"This End User Licence Agreement (EULA) is a legal agreement between you (either an individual or a single entity) and Microsoft Corporation for the Microsoft software product identified above, which includes computer software and may include associated media, printed materials, and "on line" or (electronic documentation) "product". An amendment or addendum to this EULA may accompany the product. You agree to be bound by the terms of this EULA by installing, copying, or otherwise using the product.* ***If you do not agree, do not install or use the product;*** *you may return it to your place of purchase for a full refund."*

From the plain reading of the above it is clear that Microsoft products have not been sold, but licenced. In case of sale the purchaser becomes the owner and question of further agreement for the use of the property will not arise. Apart from the above warning there are other terms and conditions attached to End User Licence Agreement. Clause (1) of the agreement deals with grant of licence and species under what circumstances the upgrades and additional software will be available. Clause (6) of the agreement deals with termination. It states "that without prejudice to any other rights, Microsoft may cancel this EULA, if you do not abide by the terms and conditions of this EULA, in which case you must destroy all copies of the product and all of its component parts". This conditions of End User Licence Agreement itself proves that the software is licenced and not sold. This fact is further buttressed by the wordings of clause 19 of EULA which states that *"the product is protected by copyright and other intellectual property laws and treaties. Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product.* ***The product is licensed and not sold."*** Another important feature of the transaction is the "Activation code" which is given by Microsoft Corporation. Before activation code is granted the end user has to enter into agreement with Microsoft Corporation known as EULA. Unless activation code is given the computer programme embedded on an electronic media cannot be used. It has explicitly been clarified in clause 19 of EULA that Microsoft Corporation or its suppliers own the title, copyright, and other intellectual property rights in the product. Thus on combined reading of clause 19 of EULA; the warning note on the EULA; and termination clause 6, it is clear that the end users have not purchased copy of software products on electronic media as contended by the assessee but a licence to use such software products. As we have held that copyrighted article means a work in which copyright subsists. Therefore the end user is not simply using the CD but the programme contained in the CD, which is protected by copyright and right to copy the programme has to be exercised before it can be put to use. Therefore, the payments made by the end users is for the granting of license in copyright and other intellectual property rights in the product and will amount to royalty u/s 9(1)(vi) of the Act.

100. After conclusion of the hearing the Revenue has filed a list of some of the cases out of large number of cases in which Hon'ble Delhi High Court disposed of plaints as below:

S.No.	Diary No. / Case No. [S T A T U S]		Petitioner Vs. Respondent A d v o c a t e	Listing date C o u r t N o.
1.	CS (OS) 994/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Anr. Vs. Mr. Gaurav Arora & Anr. Advocate: Anand & Anand	Disposed on 28/7/2009
2.	CS (OS) 993/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Anr. Vs. Mr. S. C. Aggarwal Advocate: Anand & Anand	Court No. 24 Disposed on 8/06/2009
3.	CS (OS) 992/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation Vs. Mr. Vinod Kashyap Advocate: Anand & Anand	Disposed on 12/06/2009
4.	CS (OS) 968/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Anr. Vs. Mr. Pawan Jain Advocate: Saikrishna & Associates	Disposed on 2/09/2009
5.	CS (OS) 947/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Ors. Vs. Mr. P. H. Hussain Kunnel Advocate: Saikrishna & Associates	Last date : 12/05/2010

6. CS (OS) 946/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Ors. Vs. Mr. Pranav Dalal & Anr. Advocate: Anand & Anand	Disposed on 23/09/2009
7. CS (OS) 945/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Anr. Vs. Mr. Sudhir Bajaj Advocate: Saikrishna & Associates	Disposed on 12/06/2009
8. CS (OS) 899/2009 [Disposed off]	Order(s) Judgement	Microsoft Corporation & Ors. Vs. Mr. Mahesh B. Advocate: Saikrishna & Associates	Disposed on 4/08/2009

101. A copy of decision of Hon'ble Delhi High Court granting injunction on a plaint filed by Microsoft Corporation & Another against Pawan Jain & Others for infringement of copyrights in the softwares is on records. The ld. counsel for the assessee has filed comments. The plaint has been admitted by Hon'ble Delhi High Court and the request of the plaintiff i.e. Microsoft Corporation & Another for investigation of the matter has been granted and order has been passed on May 25th, 2009[CS (OS) No.968/2009] appointing the Commissioner to investigate the matter with reference to the plaint. Since plaint is on the record of Hon'ble Delhi high court, its authenticity cannot be doubted. Microsoft Corporation & Another, the plaintiff in the plaint have stated that Microsoft Corporation is the owner of copyrights in various software products including operating systems of software, Microsoft windows operating system (various versions) and application software such as Microsoft office (various versions), Microsoft window server system etc. and development tools like visual studio, visual c++ (various versions). The grievance of the plaintiff before the Hon'ble Delhi High Court was that the defendants i.e. Mr. Pawan Jain & Others were using un-licenced / pirated versions of the plaintiff's softwares in their computer system for their business purposes. Defendant No. 2, M/s. Safexpress Pvt. Ltd. is an entity engaged in the business of providing range of logistics and supply chain solutions and is carrying on its business from its corporate office located at Safexpress, Cargo Complex, Safex centre, National Highway No. 8, Mahipalpur Extn., New Delhi - 110 037. Shri Pawan Jain is the Managing Director of

M/s. Safexpress Pvt. Ltd. As per the plaint the plaintiffs have received information in May, 2009 that the defendants were using large volumes of software programmes belonging to the plaintiffs including Microsoft windows, Microsoft office products, windows server, visio etc. on about 380 computer systems including laptops for their business and other commercial purposes at its office. On the basis of information available in the office it has been stated by the plaintiff that defendants have made volume purchases of 99 licenses of Microsoft office standard, one licence of Microsoft project, one licence of Microsoft visio professional, 9 licences of window server with 660 Client Access License (CAL), 250 windows terminals servers and 75 microsoft windows of updates. It has been stated in the plaint that when an entity has a large number of computer systems it normally opts for multiple licences rather than individual packs as volume purchases of individual packs are not feasible from a cost point of view and the plaintiff has a record of all multiple licences held by every customer. The plaintiffs have contended that the fact that the defendants have 350 computer systems and the number of licences held by the defendants does not match with their usage indicates that the defendants were indulging in multiple unlicenced use of licences of Microsoft Corporation. After hearing the Hon'ble Delhi High Court has appointed local commissioners to visit various premises of defendants located in Delhi, Bangalore & Sicandrabad simultaneously without prior notice to defendants and prepare inventories of all unlicenced / pirated softwares of plaintiffs in the computer system / hard disc or in the impact discs / DVDs or any other storage media of defendants at their premises and seize only such storage medias in the central processing unit or outside the central processing unit having unlicenced / pirated softwares of the plaintiffs. They were required to submit reports within two weeks after executing the commission.

102. From the above, it is clear that the computer programmes whether in FPP or VPP contain copyright in them. At one hand the assessee is contending that the Microsoft products sold to the end users are copyrighted articles are products and do not contain copyright. On the other hand, under Copyright Act they are enforcing their rights stating

that the use of unlicenced/pirated copy of software products involves infringement of copyrights. The Microsoft Corporation has got injunction orders from Hon'ble Delhi High Court in a large number of cases. The assessee is thus blowing hot and cold in the same breath on the same issue. When payment of tax is concerned, it is sale of "copyrighted" article and not a licence, but when question of infringement comes, plaints are filed before Hon'ble Delhi High Court claiming that the end users have indulged in use of unlicenced/pirated products. From the decisions of Hon'ble Delhi High Court granting injunctions under the Copyright Act it is proved beyond doubt that computer programmes licenced by the assessee whether in FPP or VPP contain copyright in them.

103. As discussed above under the Copyright Act, 1957 computer programme is a literary work, but section 115(1A) deals with the computation of tax payable on royalties in respect of copyright in any book and in respect of any computer software. The Parliament while prescribing special rates and mode computation of tax has made clear distinction between a copyright in any book which is in the nature of literary work and any computer software. It means for the purposes of the Copyright Act, 1957 computer software is a literary work, but for the purpose of Income-tax it is not so. Further second proviso was inserted to section 9(1)(vi) with effect from 1/04/1991, according to which the provisions of section 9(1)(vi) shall not apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer waste equipment under any scheme approved under the Policy on Computer Software Exports, Software Development and Training, 1986 of Government of India. According to ld counsel for the assessee second proviso to section 9(1)(vi) cannot create charge so as to bring the computer software under the provisions of royalty. According to him an amendment to section 9(1)(vi) is necessary without which royalty from computer software cannot be taxed. It cannot be read into it by implication. He has also stressed

that even in Indo-US DTAA entered on 20.12.1990 computer programme has not been incorporated though it got protection in the Copyright Act as literary work long back in 1984. On the other hand the contention of Revenue is that since a proviso carves out an exception from main section the royalty from computer programme was inbuilt in section 9(1)(vi) of the Act since its inception.

104. We have heard both the parties and gone through their submissions carefully. As per section 9(1)(vi) of the Act the income by way of royalty payable by the Government; or a resident ;or a non-resident shall be deemed to accrue or arise in India. The term royalty has been defined in Explanation 2 to section 9(1)(vi) of the Act. In *Keshavji Ravji & Co.* v. *CIT* [1990] 183 ITR 1 (SC), the Supreme Court said that an *Explanation,* generally speaking, is intended to explain the meaning of certain phrases and expressions contained in the statutory provisions. There is no general theory as to the effect and intendment of an *Explanation* except that the purpose and intendment are determined by its own words. An *Explanation* depending upon its own language might supply or take away something from the contents of a provision. It is also true that an *Explanation* may be introduced by way of abundant caution in order to clear any mental cob-webs surrounding the meaning of the statutory provision spun by interpretative errors and to place what Legislature considers to be true meaning beyond any controversy or doubt. In view of decision of Hon'ble Supreme court in Keshavji Ravji & Co. v. CIT (supra) Explanation 2 has to be read as part and parcel of section 9(1)(vi) of the Act.

105. Normally, a proviso is meant to be an exception to something within the main enactment or to qualify something enacted therein which but for the proviso would be within the purview of the enactment. In other words, a proviso cannot be torn apart from the main enactment nor can be used to nullify or set at naught the real object of the main enactment. Sometimes a proviso may be embedded in the main provision and becomes an integral part of it so as to be a substantive provision itself. But such a substantive

provision will have to be within the framework of the main section of which it is a proviso.

106. In State of Rajasthan v. Mrs. Leela Jain AIR 1965 SC 1296, section 4(1) of the Rajasthan City Municipal Appeals (Regulation) Act, 1950 fell for consideration before Hon'ble Supreme Court. An order passed by the President of the Municipal Council was set aside by the State Government in purported exercise of its jurisdiction under the proviso to section 4(1) which reads as follows:

> *"4. Second municipal appeals and revision - (1) Notwithstanding anything contained in any municipal law, no municipal appeal shall lie from any order passed in appeal under section 3. Provided that the Government may, of its own motion or on the application of a Municipal Authority or of an aggrieved person call for the record of any case for the purpose of satisfying itself as to the correctness, legality or expediency of any order passed by a Commissioner or a Municipal authority and may pass such orders therein as the Government may consider fit and reasonable.*
>
> *(2) Any municipal appeal from orders made in appeal by an officer or authority other than Municipal authority, pending at the commencement of this Act, shall be transferred to the Government and be disposed of in accordance with the proviso to sub-section (1)."*

107. Hon'ble Rajasthan High Court expressed the view that the Government had no jurisdiction to interfere under the proviso to section 4 with any order passed in appeal by the Municipality. That view was negatived by the Supreme Court by observing (page 1300) :

> *"The primary purpose of the proviso now under consideration is, it is apparent, to provide a substitute or an alternative remedy to that which is prohibited by the*

main part of section 4(1). There is, therefore, no question of the proviso carrying out any portion out of the area covered by the main part and leaving the other part unaffected. What we have stated earlier should suffice to establish that the proviso now before us is really not a proviso in the accepted sense but an independent legislative provision by which, to a remedy which is prohibited by the main part of the section, an alternative is provided. It is further obvious to us that the proviso is not co-extensive with but covers a field wider than the main part of section 4(1)".

108. In *UP State Road Transport Corporation* v. *Mohd. Ismail* (AIR 1991 SC 1099), Hon'ble Supreme Court while interpreting the proviso to regulation 17(3) of the UP State Road Transport Corporation has held that sometimes a proviso in effect becomes a substantive provision. Regulation 17(3) of the UP State Road Transport Corporation reads as follows:

"17(3) The service of a person who fails to pass the fitness test, referred to in sub-regulation (2), may be dispensed with; Provided that the persons, whose services are dispensed with may, in the discretion of the Corporation, be offered alternative jobs."

109. On further appeal Hon'ble Supreme Court observed :

"The proviso with which we are concerned in regulation 17(3) does not carve out an exception from the general rule contained in the first branch. It is an independent and substantial provision providing discretion to the Corporation to offer an alternative job to the retrenched driver. This offer is to be made after the exercise of power under the first branch of regulation 17(3). There is, therefore, no doubt that the second branch of regulation 17(3) is a substantial provision and not in the nature of a proviso to the first branch thereof."

110. Second proviso to section 9(1)(vi) was inserted in the statute by the Finance (No 2) Act, 1991 w.e.f. 1.4.1991 and reads as under:

> *"Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India."*

111. On plain reading of second proviso to section 9(1)(vi) we find that the proviso carves out an exception from main section exempting lump sum payment made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Export, Software Development and Training, 1986 of the Government of India. It cannot stand on its own legs and hence cannot be held as a substantive provision. It would, therefore, mean that section 9(1)(vi) from very inception included computer software for the purposes of royalty. If is not so, then how anything can be taken out from a bundle of things which do not include the same. If royalty income from the use or the right to use or transfer of all or any right (including the granting of the licence) in respect of copyright in computer programme was not taxable u/s 9(1)(vi) of the Act, the Parliament would not have prescribed special rate of income tax in respect of royalty income in respect of any computer software u/s 115A(1A). It cannot be presumed that the Parliament was not aware of provisions of section 9(1)(vi) of the Act while enacting section 115A(1A). The most basic rule of interpretation is embodied in the Latin maxim *ex visceribus actus.* Put it simply, this means a statute has

to be read as a whole and not piecemeal. Interpretation must not only be close to the statutory language but should also not lead to conflict with the other provisions of the statute. The intention of the Legislature must be found by a reading of the statute as a whole and in its context which is derived from the contextual scheme. Hon'ble Supreme Court in Unique Butyle Tube Industries (P.) Ltd. v. UP Financial Corporation [2003] 2 SCC 455 held that every part of a section should be interpreted in terms of its own context and in relation to other part of the section and ultimately the interpretation placed in a particular provision should result in the whole statute remaining a consistent enactment. Similarly in Poppatlal Shah v. State of Madras AIR 1953 SC 274 at page 276, para (7), held as under:

> "It is a settled rule of construction that to ascertain the legislative intent, all the constituent parts of a statute are to be taken together and each word, phrase or sentence is to be considered in the light of the general purpose and object of the Act itself."

112. In view of above it clear that provisions of section 9(1)(vi) have to be considered in the light of provisions of section 115A(1A) of the Act. We, therefore, reject the contention of the assessee that without amendment of section 9(1)(vi) royalty income from the use or the right to use or transfer of all or any right (including the granting of the licence) in respect of copyright in computer programme cannot be taxed u/s 9(1)(vi) of the Act.

113. We may also like say that the use of expressions "in respect of copyright in any book to an Indian concern" or "in respect of any computer software to a person resident in India" in section 115A(1A) by legislature shows that for the purposes of income tax the copyright in "computer software" is different from copyright in any "book" though both are literary works under the Copyright Act, 1957. The Income tax Act and the

copyright Act operate in different fields. The object of the Copyright Act is to provide protection to the copyrights in various works of the authors whereas the purpose of income tax is levy and collect tax on various types of incomes. Therefore, provisions of income tax Act cannot be explained by resorting to various provisions of the Copyright Act, 1957. However, a limited reference to understand the meaning of term 'copyright' can be made to the Copyright Act, 1957 as this term has not been defined under IT Act, 1961. Therefore, any reference to Indian Copyright Act 1957 has to be made for the limited purpose of finding out the meaning of the word 'copyright' and that too for the reason that the term ‘copyright’ is not defined in the Income tax Act or the DTAA. Our view is supported by the decision of Hon'ble Supreme Court in the case of Jagatram Ahuja (supra) wherein it has been held that the interpretation in one statute cannot be made applicable to another statute.

114. From the above discussion it is clear that copyright subsists in computer programme. It is a literary as also scientific work. The computer programme is also a patent, invention or process. As discussed above that Explanation 2 to section 9(1)(vi) deals with the royalty of two types i.e. industrial royalties which arises on transfer or any rights (including the granting of a licence) in respect of a patent, invention or use of any patent, invention or process. Therefore, if the end-users have made payment for transfer of rights (including the granting of a licence) in respect of copyright, patent, invention, process, literary or scientific work, such payment would be in the nature of royalty. Clause (v) of section 9(1)(vi) deals with transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work. The payment will be in the nature of royalty.

115. The Finance Act, 2007 inserted the following Explanation to section 9 with retrospective effect from 1/06/1976, which reads as under:-

> *"Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, where income is 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 the non-resident has a residence or place of business or business connection in India".*

116. Further by the Finance Act, 2010 with retrospective effect from 1/06/1976 the Explanation inserted by the Finance Act, 2007 has been substituted by the following Explanation:-

> *" Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and 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; or*
>
> *(ii) the non-resident has rendered service in India"*

117. From plain reading of the Explanation inserted with effect from 1/06/1976 by the Finance Act, 2007 which has been again substituted by the Finance Act, 2010 with retrospective effect from 1/06/1976 it is clear that income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) irrespective of the fact whether the non-resident has a residence or a place of business or business connection in India or the non-resident has rendered services in India. Therefore, once the consideration is received by non-resident for the transfer or all or any rights including the granting of a licence in respect of a patent, invention, model, design, secret

formula or process or similar property or any copyright literary, artistic or scientific work, the consideration received shall be deem to accrue or arise in India and will be taxable in India. In earlier paragraphs we have held that the payments made by end-users are inspect of the grant of licence in copyrights in computer programmes and are in nature of royalty. Hence, by virtue of amendment made by inserting Explanation to section 9(1)(vi) royalty income will be taxable in India. Therefore the contention of assessee that in the absence of any business connection or PE in India the payments received by non-resident assessees cannot be taxed India, is rejected.

118. Section 90 of the Income-tax Act provides relief from double taxation and reads as under:

> "90 (1) The Central Government may enter into an agreement with the Government of any country outside India—
>
> (*a*) for the granting of relief in respect of—
>
> (*i*) income on which have been paid both income-tax under this Act and income-tax in that country; or
>
> (*ii*) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or]
>
> (*b*) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or
>
> (*c*) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or
>
> (*d*) for recovery of income-tax under this Act and under the corresponding law in force in that country,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company."

119. The four clauses of sub section (1) lay down the scope of power of Central Government to enter into an agreement with another country. Clause (a) contemplates situations where tax has already been paid on the same income in both the countries and that case it empowers the Central Government to grant relief in respect of such double taxation. Clause (b) of section 90 which is wider than clause (a) provides that an agreement may be made for the avoidance of double taxation of income under this act and the corresponding laws enforced in that country. Clause (c) and (d) essentially deal with the agreements made for exchange of information, investigation of cases and recovery of Income-tax. The effect of an agreement made pursuant to the section 90 is

that if no tax liability is imposed under this Act, the question of resorting to agreement would not arise. No provision of the agreement can fasten a tax liability when the liability is not imposed by this Act. If a tax liability is imposed by this Act, the agreement may be resorted to for negativing or reducing it. In case of difference between the provisions of the Act and of an agreement under section 90, the provisions of the agreement shall prevail over the provisions of the Act and can be enforced by an appellate authority or the court. However, as provided by sub section (2) the provisions of this Act will apply to assessee in the event they are more beneficial to him. Where there is no specific provision in the agreement, it is the basic law i.e. the Income-tax Act which will govern the taxation of income.

120. Another contention of the ld. AR of the assessee is that Article 12(7) of Indo-US DTAA deals with source rule for taxation of royalty which provides for the situation under which a royalty can be considered as arising in India under Article 2(2). He has further submitted that there is no use of copyright in India by the end-user and the transaction is in the nature of sale of copyrighted article effected by Microsoft Oporation in Singapore and, therefore, copyright was not used in India. He further submitted that the Revenue can invoke Article 12(7)(b) of Indo-US DTAA for imposition of tax only if Microsoft Operation, Singapore instead of manufacturing and distributing products in Singapore chooses to do from India, in which case by virtue of expression 'use in India' would get the domain power to tax. But in assessee's case the use of copyright is the right to copy the master copy sub-licensed by the assessee to Microsoft Operations and this right to copy the master copy was exercised. Accordingly, Article 12(7)(b) is not attracted. On the other hand the ld. counsel for the Revenue has submitted that the contention with regard to the sale being in the source country or the business being conducted in the source country may be valid arguments for income under the head 'business or profession'. Therefore, the contention of the assessee is not valid. He further

submitted that income from royalty is taxable under provisions of section 9(1) of the Income-tax Act, 1961.

121. We have heard both the parties. Article 12 of Indo-US treaty deals with the assessment of royalties and fee for included services. Relevant provisions of Article 12 relating to royalties are extracted as below:

> "ARTICLE 12 - *Royalties and fees for included services* - *1.* Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
>
> *2.* However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed :
>
> (*a*) in the case of royalties referred to in sub-paragraph (*a*) of paragraph 3 and fees for included services as defined in this Article [other than services described in sub-paragraph (*b*) of this paragraph] :
>
> (*i*) during the first five taxable years for which this Convention has effect,
>
> (*a*)15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company ; and
>
> (*b*)20 per cent of the gross amount of the royalties or fees for included services in all other cases ; and
>
> (*ii*) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services ; and
>
> (*b*) in the case of royalties referred to in sub-paragraph (*b*) of paragraph 3 and fees for included services as defined in this Article that are ancillary and

subsidiary to the enjoyment of the property for which payment is received under paragraph 3(*b*) of this Article, 10 per cent of the gross amount of the royalties or fees for included services.

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, trade mark, 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.

XX XX XX XX XX XX XX

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties or fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be shall apply.

7. (*a*) Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State. Where, however, the person paying the royalties or fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for included services was incurred, and such royalties or fees for included services are borne by such permanent establishment or fixed base, then such royalties or fees for included services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

(*b*) Where under sub-paragraph (*a*) royalties or fees for included services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for included services relate to services performed, in one of the Contracting States, the royalties or fees for included services shall be deemed to arise in that Contracting State.

8. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for included services paid exceeds the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of the Convention."

122. The definitions of term "royalty" as appearing in Explanation 2 to section 9(1)(vi) and paragraph 3 of Article 12 of Indo-US DTAA are identical. Paragraph 1 of Article 12 says that royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. However as paragraph 2, such royalties also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed the amount specified therein. Rate

at which tax is payable is specified in the paragraph 2 of Article 12 of Indo-US DTAA. In the case of assessee we have held that payments made by end users is chargeable to tax as royalty u/s 9(1)(vi) of the Act. As per paragraph 7(a) royalties shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State. If the person paying royalty has a permanent establishment or a fixed base there in connection with which the liability to pay the royalties is incurred and the liability is borne by such establishment or base the royalty is deemed to arise in state in which the permanent establishment or fixed base is situated. As per Paragraph 7(b) the royalties relate to the use of, or the right to use, the right or property, in one of the Contracting States, the royalties shall be deemed to arise in that Contracting State. We have already held in paragraph 75 to 82 of our order that a "copyrighted article" is one in which copyright subsists. We have also held that the considerations received by the non-resident assessee are for the use of, or the right to use copyright, patent, invention or process in India and consequently liable to tax in India u/s 9(1)(vi) of income tax Act, 1961. Further, we have also held that per Explanation inserted by the Finance Act, 2010 w.r.e.f. 1.4.1976 the income by way of royalty of a non-resident shall be deemed to accrue or arise in India under clause (vi) irrespective of the fact whether the non-resident has a residence or a place of business or business connection in India. Hon'ble Supreme Court in Commissioner of Income-tax v P.V.A.L. Kulandagan Chettiar (supra) has held that the provisions of agreement cannot fasten a tax liability where the liability is not imposed by a local Act. Where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the provisions of the Act, as is clear from the provisions of section 90(2). Section 90(2) makes it clear that the Act gets modified in regard to the assessee in so far as the agreement is concerned if it falls within the category stated therein. No such case conflict between income tax Act and the treaty has been made out by the ld counsel for the assessee. Therefore, in our considered opinion there is no merit in the arguments of ld counsel for the assessee that copyright was not used in India and therefore, stands rejected.

123. We have in preceding paragraph observed that no case of conflict between the provisions of the Act and the Indo-US treaty was made out by the assessee. For a moment for sake of argument it is presumed that such a difference exists, in that situation under section 90 the provisions of the agreement shall prevail over the provisions of the Act. We would like to deal with such a hypothetical situation. The binding nature of the treaty is not without exceptions. The later domestic tax legislation may over-ride tax treaty provisions whenever there is an irreconcilable conflict. Sovereign power of the Parliament extends not only to the making but also breaking a treaty. Unilateral cancellation of tax treaty through an amendment to the internal law subsequent to conclusion of the treaty is a recognized sovereign power. If after the agreement has come into force, an Act of Parliament is passed which contains contrary provision, the scope and effect of the legislation cannot be curtailed by the reference to the agreement. The agreement is entered into pursuant to the power conferred upon the Government by section 90. Subsequent legislation cannot be controlled by the agreement. In the instant case Indo-US DTAA was entered on 20/12/1990. By an Amendment to section 9(1) by insertion of Explanation with effect from 1/06/1976 the royalties will deem to accrue or arise in India whether or not the non-resident has a residence or place of business or business connection in India. Therefore, by this amendment the income by way of royalty will deem to accrue or arise irrespective of contrary provision in Indo-US DTAA. Hon'ble Supreme Court in the case of Gramophone Company of India Vs. Virendra B. Pandey AIR 1984 SC 667 held as under:-

> *"National courts cannot say "Yes" if the Parliament has said no to a principle of international law. National courts will endorse international law but not if it conflicts with national law. National courts being organs of the National State and not organs of International law must perforce*

apply national law, if international conflicts with it. But the Courts are under an obligation within legitimate limits, to so interpret the Municipal Statute as to avoid confrontation with the comity of Nations or the well established principles of international law. But if the conflict is inevitable, the later must yield."

Further Explanation to section 9(1), as discussed above, was inserted by the Finance Act, 2007 with retrospective effect 1/06/1976 which has been further substituted by Finance Act, 2010 with the same date i.e. 1/06/1976. The legislature by these amendments has declared that the income of a non-resident shall be deem to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of section 9(1) and shall be included in the total income of a non-resident whether or not the non-resident has residence or place of business or business connection in India or the non-resident has rendered services in India. Hence, once it is found that income by way of royalty has deemed to accrue or arise in India such income shall be included in total income of the non-resident whether or not the non-resident has a residence or place of business or business connection in India.

124. The ld. counsel for the assessee in the course of his arguments has placed reliance on OECD Commentary. He has also submitted that the computer programme has not been specifically mentioned in Indo-US DTAA. He has also submitted that in the treaties entered by the Government of India between 1996 and 2000 with Turkmenistan, Russia, Morocco, Trinidad and Tobago, Kyrgyz Republic and Malaysia the expression computer software has been specifically incorporated in Article 12(3), which is absent in the case of Indo-US DTAA. He has also mentioned several conventions to which India is also a signatory. In this regard we would like to mention that OECD Commentary contains the views of the authors. The commentary cannot be equated with the decision of the apex court or the law enacted by the Parliament. Therefore, while interpreting the provisions of the Income-tax Act and Indo-US DTAA, reliance cannot be placed on OECD

Commentary. Though the developed countries are following OECD model convention, but a large number of them had reservation in following the OECD commentary. Therefore, in all humility we decline to agree with the proposition of the ld. counsel for the assessee to rely on the OECD Commentary, particularly in view of the fact that India has clear reservations on OECD Commentary. We may also like to state here that there was cleavage of opinion amongst the group of technical advisors on the issue as to whether a copyrighted article has copyright in it. The majority view was that it does not have copyright in it and is a product. However, the minority view was that the copy of a computer programme has copyright in it. We would also like to observe that we are not deciding the issues relating to International law in relation to various treaties to which India is a signatory. Whenever, a treaty is signed by India, the Government makes necessary provisions in relevant law and rules. So far as income tax matters are concerned the policy of the Government of India towards taxation of a particular income is incorporated in Double Taxation Avoidance Agreement which becomes part of Income-tax Act by virtue of section 90(2) of the Act. The Double Taxation Avoidance Agreements are negotiations between the two countries and the policy of contracting States with regard to assessment of different incomes is incorporated in the treaties. Therefore, the matter has to be decided as per the provisions of Income-tax Act and the terms and conditions stipulated in Double Taxation Avoidance Agreement. Our view is supported by the decision of Hon'ble Supreme court in the case of P.V.A.L. Kulandagan Chettiar (supra).

125. Now coming to the merits of these cases first we would like to dispose of the appeal filed by Microsoft Corporation for assessment year 1996-97. For the reasons discussed above the payments received by Microsoft Corporation from end users through distributers in respect of sale of computer softwares will be taxable as royalty u/s 9(1)(vi) of the Act.

126. In the case of Gracemac Corporation under Parent- subsidiary agreement Microsoft Corporation granted exclusive rights to M/s. Gracemac Corporation, a wholly owned subsidiary to manufacture and distribute Microsoft products, who in turn granted non-exclusive right to manufacture and distribute the Microsoft products to Microsoft Operations, another wholly owned subsidiary of Microsoft Corporation. Non-exclusive distribution rights for Asia were further transferred by MO to Microsoft Regional Service Corporation, Singapore, again a wholly owned subsidiary Microsoft Corporation. Normally the end-user licence agreement should have been signed between the Gracemac and the end-users, but since the copyrights in the computer programmes are with Microsoft, the agreement was entered into between Microsoft Corporation and the end user. If such an agreement is not made the Microsoft products on CD or electronic media would have been a dumb CD and would not have fetched any amount. From clause -19 of EULA specifically mentions that *"Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product".* When Microsoft Corp. and its supplier own copyrights and other intellectual rights in the products, it is immaterial as to have to sign the EULA. It is also a fact that Microsoft Corp has granted exclusive rights in lieu of all the shares of Gracemac Corporation and no further royalty is being paid by Gracemac for exclusive rights granted to it by Microsoft Corp. The reason is obvious. Whatever will be the resultant profits after meeting the expenses it will belong to Microsoft Corp. being holding company.

127. There is another aspect of matter. Though it has been argued that MRSC has been granted distribution rights by MO vide agreement dated 4.1.1999. However, MO has also granted reproduction rights to MRSC, which is evident from the definition of “Select Product” in Exhibit A to Schedule-B to the Enrollment Agreement extracted as below:

> “Select Product” shall mean the licences and CD-ROM’s which comprise a Select Software Product. Select Software Product shall mean the MO software as

designated from time to time by MO which may be reproduced pursuant to an Enrollment Agreement."

Further Microsoft Operation vide agreement dated 3.5.1999 replaced article 3.2 of agreement dated 4.1.1999 with the following:

> *" 3.2 Marketing Program Manufacturing and Distribution : MO shall provide Distributor with the master copy (whether through diskettes or other media) for the Marketing Programs and the camera ready or other materials for the packaging and documentation. Such materials shall be provided to Distributor at prices set forth on Schedule A. Distributor shall then have the right to copy the Marketing Program(s) in object code form from the master copy provided by MO onto either diskettes or such other media as MO approves, prepare the product documentation and packaging based on the materials provided and approved by MO provided that all documentation remains complete and accurate, and assemble the final Marketing Programs. Each product package will include a pre-approved diskette label attached to the diskette and MS Corp.'s standard end user license agreement for the Territory. All master copies and other material shall remain the sole property of MS Corp. and Distributor agrees not to make any copies of the master copies except as provided herein. Distributor may subcontract all or any portion of the manufacturing of the Marketing Programs; provided Distributor continues to meet all of its obligations set forth in this Article. Distributor agrees that the Marketing Programs if manufactures will meet the quality standards set by MS Corp. in its written specifications. As a guide, it is the parties' intention that the quality of the Marketing Programs produced by Distributor will be approximately equivalent in quality to the software products manufactured by MS Corp. MO shall provide Distributor with updated master copies if and when MS Corp. updates the Marketing*

Programs. Distributor agrees to pay a royalty to MO for each Marketing Program and update manufactured and distributed by Distributor pursuant to this Article. The royalty amount and payment method shall be as set forth on Schedule A.

Distributor may purchase Marketing Programs from MS Corp. or any MS Corp. affiliate. Distributor may sell Marketing Programs to distributors, resellers, vendors, end users and any MS Corp. affiliate"

128. From the above it is evident that MRSC was also authorized to reproduce certain products and distribute the same to end users through the distributors appointed by MRSC. MRSC vide agreement dated 3rd May, 1999 was authorized to copy the marketing programmes in object code form from the master copy provided by Microsoft Operations (MO) on to either diskettes or such approved media and prepare the product documentation and packaging based on the material provided and approved by MO. We would like to mention here that source code and object code have copyright. Therefore, MRSC also got right to use copyright in computer products from sub-licencee (MO). Each product package would include a pre-approved diskettes label attached to the diskettes and MS Corp. standard End User Licence Agreement for the territory. From the above it is evident that MRSC is not simply a distributor appointed by Microsoft Operations, but was authorized to reproduce certain computer programmes. The End User Licence Agreement was to be in the standard format of Microsoft Corporation. Article 3.2 also provides that the marketing programme released by the distributor will be approximately equivalent in quality of the software product manufactured by MS Corp. The Microsoft Operation also provided up-dated master copies of marketing programmes as and when the same were up-dated by MS Corp. Since the Microsoft Corporation has granted the right to reproduce and distribute Microsoft Products in lieu of Shares to Gracemac and no further royalty is payable by Gracemac and also the End User Licence Agreement is to be in the standard format of Microsoft Corporation, the Microsoft Corp. is under obligation to sign EULA on behalf of Gracemac. Thus it has to be logically

concluded that Microsoft Corporation has signed the EULA on behalf of Gracemac to whom exclusive rights to manufacture and distribute Microsoft products have been granted otherwise the products would have been rendered useless and no revenue could have been earned by anyone in the supply chain. Microsoft Corporation has devised a scheme under which EULA has to be signed by Microsoft Corp. and not by Gracemac Corporation. Hence assessee cannot be permitted to take a plea that since EULA has been signed between end users and Microsoft Corp. no licence was granted by Gracemac and consequently the royalty payments will not be chargeable to tax in the hands of Gracemac. The agreements entered into between group companies have drafted in such a way which give an impression that Gracemac Corporation has no connection with the granting of licence. The real transaction of the granting of the licence in respect of copyrights in computer programmes have camouflaged by entering into various agreements between Microsoft and Gracemac; Gracemac and Microsoft operations; Microsoft operation and MRSC; and MRSC and Indian distributors but when real intention is gathered from the in-depth reading of the agreements, the matter becomes crystal clear. Since we have held that end users have made payments in respect of the granting of licence in respect of copyright in computer programmes the payments made by end-users as consideration for the same will be taxable in the hands of Gracemac.

129. Another contention raised by the ld. counsel for the assessee before us relates to the assessment by the assessing officer assessing the income from royalty under section 9(1)(vi)(c) of the Act, which is applicable in the case of a non-resident making payment of royalty to another non-resident. Since there was no use of copyright in India the income could not be assessed under section 9(1)(vi)(c) of the Act. In this regard, we would like to observe that the ld. CIT (Appeals) while confirming the stand of the assessing officer has held that income will be assessable under section 9(1)(vi)(b) which is applicable in the case of payment of royalty by a resident to a non-resident. Provisions of section 9(1)(vi)(b) are applicable where royalty is paid by a resident and that of 9(1)(vi)(c) by non-resident in respect of any right, property or information used or

services utilized for the purpose of business or profession carried on by such person in India or for the purpose of making or earning any income from any source in India. Section 4 of Income-tax Act is charging section and section 5 defines the scope of total income. Under section 5(2), subject to the provisions of Income-tax Act, 1961, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which - (a) is received or is deemed to be received in India in any such year by or on behalf of such person; or (b) accrues or arises or is deem to accrue or arise to him in India during such year. In the case before us we have arrived at a conclusion that the payments made by end users for the granting of licence in respect of copyright in computer softwares is in the nature of royalty. The payments have been made by residents and, therefore, the same is assessable to tax under clause (b) of section 9(1)(vi). The assessing officer has assessed the income under clause (c) whereas the ld. CIT (A) has directed the assessing officer to assess under clause (b) of section 9(1)(vi) of the Act. The assessment made by the assessing officer by applying a wrong clause cannot be a basis for deletion of addition. The commissioner of Income tax (appeals) under section 250 has co-terminus power with that of the assessing officer as held by Hon'ble Supreme Court in the case of CIT Vs. Kanpur Coal Syndicate 53 ITR 225 (SC). The ld. CIT (A) can do what the Income-tax Officer do and can also direct him to do what he has failed to do. The ld. CIT (A) exercising his powers conferred upon him by section 251(1)(a) of the Income-tax Act, has directed the assessing officer to assess the royalty income under section 9(1)(vi)(b) of the Act. Therefore, no irregularity can be found with the order of the ld. CIT (Appeals) bringing the royalty income under section 9(1)(vi)(b) of the Act. Accordingly, this contention of the assessee is dismissed.

130. The ld. counsel for the assessee has relied on the decisions of several Benches including the decision of Special Bench in the case of Motorola (supra). In the case of Motorola (supra) the issue involved related to case of a cellular operator, who had been denied the right to make copies of the software except for archival back-up purposes

whereas in the case of the assessee licence has been granted for the use of software. The assessee has granted the end users the right to make copies not only for archival purposes, but also for installation of the programmes on the hard disc. In the case of Motorola (supra) the software was part of hardware and it has no use or value independent of it whereas in the case of assessee the computer programme is licenced with the right of reproduction though for limited use. For the ratio of the decision in the case of Motorola that copyrighted article is a product without any copyright in it , the special Bench has relied on US Regulations and OECD commentary. Whereas we have followed the decision of Hon'ble Supreme Court in the case of P.V.A.L. Kulandagan Chettiar (supra) wherein it has been held that taxation policy is within the power of the Government and section 90 of the Income-tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income-tax Act, it would be unnecessary to refer to the terms addressed in OECD commentary or in any of the decisions of foreign jurisdiction or in any other agreements. Moreover in the case of assessees before us Microsoft Corporation has been filing petitions every year before Hon'ble Delhi High Court contending that use of computer programme embedded on CD/ electronic media (copyrighted article) without licence is infringement of copyright and Hon'ble Delhi High court has granted injunction and other remedies to the petitioner. Hence facts of the cases before us are distinguishable with that of the case of Motorola. Similarly, in the decision of Lotus Development Pte. Ltd., the Bench has placed reliance on the decision of TCS Ltd.(supra) and Motorola (supra). As held above, the decision of Hon'ble Supreme Court in the case of TCS Ltd. (supra) is not applicable to the Income-tax proceedings and same is the position with the decision of Special Bench in Motorola, hence reliance on the decision of the ITAT in the case of Lotus Development Pte. Ltd. is of no help to assessees. Similarly, in the case of Samsung Electronics (supra) the ITAT had placed reliance on the decision of TCS Ltd. In the case of Infrasoft Ltd. (supra) ITAT placed reliance on the decision in the case of Motorola (supra) and in the case of Samsung (supra). Likewise, in the case of Sonata Information

Technology (supra) reliance has been placed on decision of Hon'ble Supreme Court in TCS Ltd. (supra) and other decisions. When a decision is held to be inapplicable, the subsequent decisions rendered relying on inapplicable decision will also not be applicable. Similar is the position with reference to the other decisions wherein reliance has been placed on the decision of Motorola Inc. (supra). Since these decisions are distinguishable on facts and law and for the reasons discussed in earlier paragraphs, in our considered opinion, the decisions relied upon by the assessee are of no help.

131. Another contention of the ld. AR of the assessee is that Microsoft Operations and Gracemac are legal façade. Microsoft Operations was incorporated under laws of United States and MRSC under the laws of Singapore and had been issued residency certificates. Once these assessees have been issued tax residency certificates by authorities of respective countries, to consider such entities as fictitious or to say that the companies are legal facade is not justified. Hon'ble Gujarat High Court in the case of Arabian Express 212 ITR 31 has held that when a Sovereign State recognizes the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other Sovereign State including India to recognize the same and it is not open to Revenue to declare these entities as façade without any basis and this finding of ld CIT(A) has to be reversed. We order accordingly.

132. As discussed above, MRSC reproduced certain software products and distributed the same through chain of distributors in India. Therefore, the very appointment of distributors by MRSC in India, had business connection in India and the portion of income earned by MRSC perhaps could have been chargeable to tax as business income under section 9(1)(i) of the Act. But since the assessing officer as well as the ld. CIT (Appeals) has chosen to assess the entire receipts under the head 'royalty' in the hands of MRSC also, in our considered opinion, MRSC cannot be taxed again on the same income by way of royalty for exploitation of same rights which had been assessed in the hands of

Gracemac, otherwise it would result in double taxation. Therefore, we delete the addition in the hands of MRSC for all the three years.

133. The last issue for consideration relates to levy of interest under section 234-A, B and C of the Act. Since the issue is now covered by the decision of Hon'ble Supreme Court in the case of CIT Vs. Anjum MH Ghaswala (supra) wherein it has been held that charging of interest under sections 234-A, B and C is mandatory in nature, the same has to be charged. We, therefore, upheld the levy of interest under sections 234-A, B and C of the Act.

134. Before parting with the issue we would like to mention that the case was fixed for clarification on the ground that the assessees have filed proceedings under MAP. During the course of hearing it was argued by the ld. AR of the assessee that in MAP proceedings the assessees have not accepted tax liability and therefore, the appeals filed by the assessees before the ITAT can be proceeded with independent of MAP proceedings. Reference was made to the decision of Special Bench in the case of Motorola (supra). On the other hand, the ld. counsel for the Revenue, submitted that filing of proceedings before the competent authority under MAP shows that the payments received from end users are assessable as royalties under the Income tax Act.

135. We have heard both the parties and gone through the material available on record. We find that similar issue came up before the ITAT, Special Bench in the case of Motorola (supra). In the case of the assessee (Ericsson) there was no admission on the part of the assessee that the income was taxable in India. Accordingly it was held that MAP proceedings did not come in the way of disposing of the appeal before the Tribunal. Similar is the case before us. The assessee has not accepted the tax liability in the MAP. Since this issue is covered by the decision of Special Bench in the case of Motorola (supra) it is held that filing of petitions under MAP will not come in the way

of deciding the issue by the Tribunal. Accordingly, we have proceeded to decide the appeals on merits.

136. In the result, the appeals filed by Microsoft Corporation and Gracemac are dismissed and the appeals filed by MRSC are allowed.

The order pronounced in the open court on : **26th October, 2010**.

Sd/- Sd/-

[RAJPAL YADAV]
JUDICIAL MEMBER

[K. D. RANJAN]
ACCOUNTANT MEMBER

Dated : 26th October, 2010.

MEHTA

" Copy of the order forwarded to : -

1. Appellants.
2. Respondents.
3. CIT,
4. CIT (Appeals),
5. DR, ITAT, NEW DELHI.

True Copy. By Order.

Assistant Registrar, ITAT. "