IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : "A" NEW DELHI

BEFORE SHRI J.SUDHAKAR REDDY, A.M.
AND SHRI GEORGE GEORGE K, JM

ITA nos. 1124 & 1125/Del/2014
Assessment Years : 2004-05 and 2010-11

Aspect Software Inc. C/o Rashmi Chopra (Advocate) C 56, Nizamuddin East New Delhi	**vs**.	ADIT, Circle 1(1), International Taxation New Delhi

PAN: AAGCA 7513 D

C.O. no. 117/Del/2014
(In ITA no.1124/Del/2014)
Assessment Year : 2004-05
And
C.O. no. 121/Del/2014
(In ITA no.1125/Del/2014)
Assessment Year : 2010-11

ADIT, Circle 1(1) New Delhi	vs.	Aspect Software Inc. Gurgaon

ITA no. 82/Del/2011
Assessment Year : 2007-08

Aspect Software Inc. Gurgaon PAN: AAGCA 7513 D	vs.	ADIT, Circle 1(1) New Delhi

C.O. no. 118/Del/2014
(In ITA no.82/Del/2011)
Assessment Year : 2007-08

ADIT, Circle 1(1) New Delhi	vs.	Aspect Software Inc. Gurgaon

ITA no.221/Del/2013
Assessment Year : 2003-04

Aspect Software Inc. vs. ADIT, Circle 1(1)
Gurgaon New Delhi
PAN: AAGCA 7513 D

C.O. no. 240/Del/2013
(In ITA no.221/Del/2013)
Assessment Year : 2003-04

ADIT, Circle 1(1) vs. Aspect Software Inc.
New Delhi Gurgaon

ITA no. 720/Del/2013
Assessment Year : 2009-10

Aspect Software Inc. vs. ADIT, Circle 1(1)
Gurgaon New Delhi
PAN: AAGCA 7513 D

C.O. no. 120/Del/2014
(In ITA no.720/Del/2013)
Assessment Year : 2009-10

ADIT, Circle 1(1) vs. Aspect Software Inc.
New Delhi Gurgaon

ITA no. 04/Del/2012
Assessment Year : 2008-09

Aspect Software Inc. vs. ADIT, Circle 1(1)
Gurgaon New Delhi
PAN: AAGCA 7513 D

C.O. no. 119/Del/2014
(In ITA no.04 /Del/2012)
Assessment Year : 2008-09

ADIT, Circle 1(1) vs. Aspect Software Inc.
New Delhi New Delhi

(Appellant) **(Respondent)**

Appellant by:- Mrs. Rashmi Chopra, Adv.
Respondent by:- Sh. Sanjeev Sharma, CIT, DR &
Sh. Vivek Kumar, DR

O R D E R

PER BENCH

All these appeals are filed by the assessee and the Cross Objections are filed by the Revenue. These appeals arise out of separate orders passed by the Assessing Officer (hereinafter referred to as 'AO') u/s 143(3) read with section 144C(13) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') for Assessment Years (hereinafter referred to as the 'AY') 2003-04, 2004-05, 2007-08, 2008-09, 2009-10 and 2010-11 respectively. As the issues arising in all these appeals are common, for the sake of convenience they are heard together and disposed of by way of a common order. Both parties have agreed that the appeal for the A.Y. 2007-08 in ITA 221/Del/2013 be taken as the lead case and the decision in this appeal can be applied for all the other appeals. Hence we first take up the appeal for the AY 2007-08, i.e. ITA No 221/Del/2013.

ITA.No.221/Del/2013- AY 2007-08

For the subject AY, Assessee has raised 13 grounds out of which, ground No.1 is general in nature and therefore does not require adjudication. The other grounds are briefly summarized by the assessee as below:-

(a) Ground 2, 2.1 and 2.2

The learned DRP and the AO erred in holding that the revenue earned from supply of software to customers in India as "Royalty" under section 9(1)(vi) of the Act and under Article 12 of the DTAA between India and USA ('Tax Treaty')

(b) Ground 3 and 4

The learned DRP and the AO erred in holding that the revenue earned from rendering of implementation services and maintenance services to customers in

India as "Royalty"/"FTS" under Section 9(1)(vi)/(vii) of the Act and under Article 12 of the Tax Treaty.

(c) Ground 5.1, 5.2 and 5.3

The learned DRP and the AO erred in holding that the assessee has a Fixed place, Installation and Dependent Agent Permanent Establishment ('PE') in India within the meaning of Article 5 of the Tax Treaty.

(d) Ground 6 and 6.1

The learned DRP and the AO erred in holding that the revenue earned from supply of software and rendering of maintenance and professional services to customers located in Sri Lanka and Middle East as "Royalty"/"FTS" under Section 9(1)(vi)/(vii) of the Act and under Article 12 of the Tax Treaty.

(e) Ground 7 and 8

Without prejudice to assessee's contention on non-taxability of revenue mentioned in Ground 2 to 6, the AO has erred in taxing the revenue from supply of software earned and rendering of maintenance and professional services to customers located in India Sri Lanka and Middle East as "Royalty"/"FTS" on gross basis @15% and also proceeded to attribute the income to the alleged PE thereby, resulting in double taxation of income.

(f) Ground 9

Without prejudice to assessee's contention on non-taxability of revenue mentioned in Ground 2 to 6, the AO has wrongly applied the rate of 15% on supply of software and hardware and services to customers located in India, Sri Lanka and Middle East, as "Royalty"/"FTS" without considering the date of execution of the agreement and the provisions of section 115A of the Act (i.e. on or after June 2005 in accordance with section 115A of the Act)

(g) Ground 10,10.1 and 10.2

While arriving that the profits attributable to the PE, the learned AO was wrong in not allowing deduction of the remuneration paid to Aspect India by the Assessee, despite directions to this effect in Article 12(7)(b) of the Tax Treaty.

(h) Ground 11,11.1.11.2 and 11.3

The AO has earned in holding that the Transfer Pricing provisions are applicable to the Appellant. Further, that the AO has wrongly rejected the Transfer pricing analysis of Aspect India and initiated penalty proceedings for not submitting the TP report and not maintaining TP documents.

(i) Ground 12, 12.1 and 13

Challenging the levy of interest under section 234B of the Act and initiation of penalty proceedings under section 271(1)(c) of the Act.

Assessee also placed on record paper books in two volumes, from pages 1 to 308 and from pages 1 to 201.

<u>Facts in brief:-</u>

1. Aspect Software Inc ('Aspect US or the Assessee') is a corporation incorporated in Delaware State, USA. The Appellant is engaged in the business of provision of hardware, software and rendering of support services that enable call centre companies, to better manage customer interactions via voice, email, web and fax. The assessee derives its revenue primarily from supply of "contact solutions", software license and provision of services including, installation, maintenance and professional services. The assessee has also provided installation/ implementation and maintenance of the supplied hardware and software.

2. Aspect US had two subsidiaries in India – Aspect Contact Center Software India Private Limited (hereinafter referred to as 'ACC' or 'Aspect India')

and (ii) Aspect Technology Center (India) Private Limited (hereinafter referred to as 'ATC'). ACC is involved in business of installation of the equipment and providing marketing support to the assessee. ATC is the R&D entity, which involves as well as provides, testing, providing maintenance support to the assessee.

3. For the year under appeal, the assessee has earned revenues from the Indian customers as follows:

- Licensing of software: USD 65,84,468
- Sale of hardware: USD 35, 24,795
- Implementation Services : USD 4,91,174
- Maintenance Services: USD 28,79,639
- Professional Services: USD 2,07,083

4. Revenue earned from professional services, was offered to tax on gross basis in the return of income filed. With respect to other sources of income, the assessee, in the notes to the return of income, disclosed that Aspect also provides implementation services, maintenance services, warranty services, education services and technical services to Indian customers and that these services do not fall in the category of fee for included services and consideration for the above services is taxable as business profits under the treaty and in the absence of PE in India, business profit (arising from the provision of these services) is not taxable in India.

5. For detailed reasons stated in the assessment order which are discussed in the later part of this order, the Assessing Officer ('AO') held that the assessee has a Permanent Establishment in India in the form of Fixed Place, Installation as well as Dependent agent under Article 5 of the Tax Treaty. ACC, the Indian Subsidiary of assessee, was held to be PE of the assessee in India. He held that the revenue from supply of hardware was taxable as per Article 7 read with Article 5 of the Double Taxation Avoidance Agreement between India and USA

(hereinafter referred to as 'the Tax Treaty'). The AO attributed to PE in India 15% of the revenues earned by Aspect US from software licensing. He further held that revenues earned from supply of software and support services are taxable as 'Royalty'/Fees for Included Services ('FIS') under the Act and as per Article 12 of the Tax Treaty on gross basis @15%.

5.1. Having held so, he also attributed 57.5% of revenues earned by Aspect US, from rendering services to the customers located in India and outside India (i.e. Sri Lanka and Middle East), to the Indian PE. The assessee carried the matter in appeal before the DRP-I. The DRP-I, New Delhi vide its order dt. 24.9.2010 u/s 144C upheld the draft order of the AO. In this brief order the DRP rejected the contentions of the assessee and upheld the draft order of the AO. Aggrieved, the assessee is before the Tribunal. The Revenue has also filed Cross Objections with considerable delay. These Cross Objections were later not pressed by the Revenue, after arguing the same for more than two days both on the issue of condonation of delay and also on merits perhaps realizing that these Cross Objections have no merit.

6. We have heard Mrs. Rashmi Chopra, the learned Counsel for the assessee and Shri. Sanjeev Sharma, the learned CIT, D.R. on behalf of the Revenue. We have also gone through elaborate written submissions filed by both the parties from time to time and perused the materials on record. We now proceed to dispose of the grounds raised by the assessee issue wise:

Ground No 2, 2.1 and 2.2

7. Ground 2 deals with revenue earned from supply of software taxed as "Royalty" under the Act and the Tax Treaty. The Assessee sells contact solutions to the customers in India which is combination of software and

compatible hardware that enables the customer of Aspect US to answer customer request, log in complaints and route communications. The software and hardware both are integral parts of the solutions which the assessee sells to the customers and channel partners in India. While the hardware is sold, the software is licensed. With respect to software, the customer is granted partial rights permitting the use of software for internal use. The Assessee has submitted before the AO that, the revenue received from sale of software embedded with hardware is not taxable in the hands of the assessee as royalty under the provisions of the Act or under the Tax Treaty relying on the prepositions laid by the Hon'ble Delhi High Court in the case of DIT vs. Ericsson A.B. (343 ITR 470) and by the Delhi ITAT Special Bench in the case of Motorola Inc (95 ITD) on the subject. The assessee contended that the payment for software is for a copyrighted article and not for the copyright right and hence it is not taxable under Article 12 of the Tax Treaty.

8. The submissions made by the assessee were not found acceptable by the AO. The AO considered the definition of 'royalty' under section 9(1)(*vi*) of the Income-tax Act, 1961 as well as in Article 12(3) of the Tax Treaty and came to the conclusion that the amount received by the assessee from licensing of software qualified to be royalty, as per the said definitions. The reasons given by the A.O. for arriving at this conclusion were as under:

(a) The assessee is receiving the payment for conferment of a right, allowing the use of copy right etc. Thus the payment made for soft ware is for the use of a copy right and not a copyrighted article.

(b) The nature of software supplied by Aspect, USA is not shrink wrapped or off the shelf soft ware for the following reasons:

- It is specialized software having special purpose, usage, to manage and automate the billing process.
- The software is tailor made/customized to suit customer needs.

- The present software embodies “process” which is required to control or manage billing activities. Hence, it makes available, the process to its customers;

(c) The software for which the licenses have been granted, equips the user/enable the user to carry out high level technical task with precision and that these software are not the ones for running small machines. Hence, it qualifies to be technical and commercial equipment.

9. The DRP confirmed the action of the AO and held that the customer is getting a right to use the software, which can be used for internal operations in business of the customer. The nature of software is far from being ‘shrink wrapped software’. Hence, the said software falls within the ambit of section 9(1)(vi) of the Act and the Tax Treaty.

10. The learned counsel for the assesee submitted that, the Assessee sells contact solutions and enterprise workforce optimization solutions (herein after referred to as “product” or “contact solutions”), to the call center companies in India and other countries. The contact solution is a combination of both hardware and software components that enables the customer of Aspect US to answer customer request, log in complaints and route communications. The customer buys a complete solution which is manufactured outside India. The software and hardware are both integral parts of the contact solutions which the assessee sells to the end user and Channel Partners in India. The contract is between Aspect US and the customer directly. The software is provided on a Compact Disk and is shipped directly to the end user/ Channel Partner as the case may be. In support of her submissions, the learned Counsel invited our attention to the invoices raised on customers and to Clauses 1 and 5 of the agreement between Aspect US and Infovision Information Services (P) Ltd (page 83 to 116 of PB 1) forming part of paper book-I, to demonstrate that what is

sold to the customer, is product comprising of hardware and software embedded in it. It was also submitted that the hardware and software sales are made outside India by Aspect US and the title and risk of goods is passed to the end customers outside India. Therefore, in view of the decision of the Hon'ble Jurisdictional High Court in the case of DIT vs. Ericsson A.B. (Supra) 470) and the Hon'ble Delhi ITAT decisions in the case of Huawei Technologies Co. Ltd vs. ADIT (ITA No 5253/ De/ 2011), the revenue from licensing of software cannot be taxed as " Royalty" under the provisions of Sec. 9(1)(vi)(c) of the Act and under Article 12 (3) of the Tax Treaty.

11. Without prejudice to the above, the learned counsel submitted that in terms of the agreement with the Indian customers for supply of software, the software license does not grant the customer any right in the copyright. The customer is granted only a, non- exclusive, non -transferable right to use the software (i.e. licensed product) solely and exclusively for internal use. The assessee retains all the intellectual property rights in the software and merely provides a copy of the computer programme to the customer, with a limited right to use the licensed product (i.e. the computer programme in machine readable, object code form) for non productive archival and backup purposes or to replace a worn or defective copy.

12. She submitted that the definition of royalty envisages payment for transfer of right to use the intellectual property (such as copyright, patent, etc.) by the owner of such intellectual properties to any other person. Essentially royalty accrues to the owner of the copyright as consideration for commercial exploitation of the intellectual property in the copyright which is the exclusive property of the Copyright owner. Transfer of a copyrighted right means that the recipient has a right to commercially exploit the software (example reproduce, duplicate etc). The payment for such a right is classified as royalty.

13. She further submitted that copyright actually vests in a person only when he has an exclusive right to do all or any of the acts specified under the Indian copyright Act 1957. Mere making copies of a computer program for the limited purposes described in section 52(1)(aa) of the Indian Copyright Act does not infringe the copyright in such program and therefore does not involve the use of any copyright. Section 52(1)(aa)/(ad) of the Indian Copyright Act provides that, making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, in order to utilise the computer programme for the purposes for which it was supplied; or to make back-up copies purely as a temporary protection against loss, destruction or damage, in order only to utilise the computer programme for the purpose for which it was supplied; or making of copies or adaptation of the computer programme from a personally legally obtained copy for non-commercial personal use does not amount to infringement of copyright. It was further submitted that right to use a copyright in the software is distinct from right to use the programme embedded in the software. She contended that payments made for acquisition of rights in relation to the copyright which are limited to rights which are necessary to enable the user to operate the program, classify as “Business profits”.

14. Further the Ld.Counsel submitted that, for the purpose of classifying the nature of revenue stream to the Assessee as “royalty”, the Assessee should have granted at least, any one of the rights stated in Sec.14 of the Indian Copyright Act. In the present case, there is no grant of any such rights mentioned in Sec. 14(a) clause (i) to (vii) of the Indian Copyright Act to the customer. The customer is granted only a limited right to use the copyrighted article and various restrictions are imposed on the use of the software (as stated in End User Agreement), such as reverse engineering , disassembling,

decompiling, or decoding the software or any portion of them, or using any portion outside the scope of the license granted thereunder. Hence it was submitted that the assessee has not transferred the copy right, but only a copyrighted article.

15. The learned Counsel further submitted that the term “license” is not determinative of nature of payment. The customers, in the instant case, have no right to commercially exploit the software or the copyrights therein. The right is a merely a limited right to use a copy of the computer program, which is a copyrighted article. Therefore, there is a transfer of a copyrighted article and not transfer / use of a “copyright right”. Therefore, in the facts of the instant case, the income earned from transfer of licensed product (under the software license agreement) being in the nature of transfer of copyrighted article does not fall under the definition of royalty either under the Act or under the Tax Treaty. Our attention was drawn to clause 3, 8 and clause 10 of the agreement between Aspect US and Infovision Information Services (P) Ltd to demonstrate that that there is no transfer of copyright right but only a license to use a copy righted article. Further, reliance was placed on the decision of the Hon’ble jurisdictional High Court in the case of DIT vs. Infrasoft Ltd (ITA No 1034/ 2009) where in the Hon’ble Court has held that limited right to use the copyrighted material does not give rise to any royalty income.

16. Amongst many case laws cited on the subject, the Learned Counsel for the assessee has heavily relied on the following decisions in support of her arguments:

- Ericsson A.B vs DIT (Supra)
- DIT vs. Infrasoft Ltd (Supra)
- Convergys Customer Management Group Inc (58 SOT 69, Delhi ITAT)
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In support of her arguments, the learned counsel for assessee also filed a detailed summary highlighting the facts of Ericsson A.B. and Infrasoft decisions, relevant terms of the agreement in both the cases and similarity of the same with the facts of Aspect US.

17. On the Revenue's contention that revenue received would qualify as "process royalty" or" equipment royalty", the learned Counsel submitted that in the instant case, the customers are merely provided with the object code and not the source code to the software (where the information or knowledge resides). The object code is sufficient to carry out the desired function i.e. operate the software but does not convey the technical knowledge or trade secrets of the Appellant. Accordingly, no rights in a "secret process" can be said to be transferred. Further, she submitted that a computer software programme cannot be classified as equipment. She invited our attention to the report of Technical Advisory Committee constituted by the OECD to state that digital products such as software cannot be considered as "equipment" since the word "equipment" can apply only to a tangible product. In the instant case, the customers are given a computer software programme and there is no equipment of the assessee which is used by the Customer.

18. Further, she argued that despite the amendments made by the Finance Act 2012 to the definition of "royalty", the revenues arising from the sale of software are not taxable under the provisions of the Tax Treaty as the said amendment shall not have any impact on the protection available under the Tax Treaty. For this preposition, she relied on the following case laws.

- DIT vs Ericson A.B. (343 ITR 470, Del HC)
- Nokia Net Works OY (ITA 512/ 2007, Del HC)
- DIT vs. Infrasoft Ltd. (ITA no.1034/2009 , Del HC)

- Convergys Customer Group Management Inc. vs. ADIT (58 SOT 69, Del ITAT)

19. Further, she also submitted that the said revenue is not taxable under the Act irrespective of the amendments in view of the Hon'ble Supreme Court decision in the case of Tata Consultancy Services wherein it has been held that computer software is "goods". Accordingly, its sale cannot result in generation of royalty and can only be treated as sale of goods.

20. In addition to the above case laws, a number of other decisions have been cited by the Learned Counsel for the assessee. We have gone through all the decisions and we would be dealing with them as and when necessary.

21. On the other hand, the learned counsel for the Revenue submitted that the taxation of the revenue from licensing of software has been dealt in paragraphs 5 to 11 (page 14 to 41 of the assessment order). He drew our attention to the relevant clauses of the sample agreement (pages 83 to 95 of PB -I) dealing with software and relevant clauses of the channel sales agreement between Concerto Software Inc. (renamed to Aspect Software Inc.) and C.S. Infocom Pvt. Ltd, Mumbai (pages 96 to 106 of PB- I) and to another Channel sales agreement (pages 107 to 116 of PB-I) and submitted that the channel partner has right to sublicense the products which include software items (clause 3 (C) page 97 of PB -I).

22. He further submitted that the arguments of the learned Counsel of the assessee are based on the following assertions:

(a) That the software is supplied outside India and sale is made on FOB basis. This statement that the property in goods is transferred outside India is factually wrong, and that the claim is made so as to fit within the definition the contours of the decision of the Hon'ble Apex Court in the case of Tata Consultancy services (271 ITR 401 , SC). Accordingly, he argued that there is no supply of software and it is a license to use the software. Referring to clause 5(c) of the sample agreement (page 86, PB-I), he submitted that the said clause deals only with title to the equipment and not software. He argued that equipment is different from software (clause 1 of page 83 of PB-I). Ownership on rights other than the licensed rights remains with the assessee. Title in the software is neither transferred in India nor outside India. The user of the software gets only partial rights in the software to use it and the channel partner got right to sublicense the software. He further submitted that the Assessee has not provided a copy of the agreement between the Channel partner and the end user of the software. However, based on available documents it is explicitly clear that the end user gets rights to use the software and they must return or destroy the software copy after agreement is terminated.

(b) He argued that the transaction is in the nature of license and not that of a sale. The license agreement between the assessee and the end user provides that in case of termination of the license, the end user shall promptly remove all copies of the software from its systems and discontinue the use or destroy or return of the software. License agreement also provides that software cannot be sub-licensed assigned or transferred without the permission of the right holder. Referring to section 4 of the Sale of Goods Act, he argued that the section requires that in case of a sale, the property in goods should transfer to the buyer for a price. In case of licensing of software full transfer of rights do not take place and it cannot be treated as an outright sale of goods.

(c) Further, the claim that software has been supplied directly is also wrong in the case when the software is licensed to channel partner who had the right to sub license to the customers (Clause 3(C), page 97 of PB- I).

(d) The contention of the assessee that delivery is on FOB basis does not decide the taxability of transactions. The transfer of title and risks along with delivery of documents decide the event of taxation but not the taxability. In support of his argument, he relied on the decision of the Hon'ble ITAT in the case of M/s Baker Hughes Asia Pvt. Limited. The agreement is silent about the delivery of documents in relation to sale of equipments. In absence of such a provision, the documents are considered delivered at the residence of the purchaser. Title in the software always remains with Aspect Software Inc.

(e) The assesee's contention that software and hardware are co-joint and software and hardware is always sold together is factually incorrect from the submissions of the assessee on page 186 of PB- II which states that some customers purchased license for the software from the assessee without purchase of the equipment. This is evident from the invoice filed on page 10 of PB- I wherein software only has been licensed. On a query from the Bench on this point, the learned Counsel for the assessee fairly admitted that software is not embedded in the equipment in some cases. Therefore the decision of the Hon'ble Delhi High Court in the case of Ericsson and Nokia (supra) would not apply to the case of the assessee in respect of revenue from such customers. The learned CIT-DR also filed detailed submissions as to the non –applicability of Ericsson case to the facts of the present case.

(f) On the argument of the assessee that billing is done from the USA, payments are made outside India and shipment is made to India, the learned CIT-DR submitted that it cannot be verified whether billing is from the USA as the same can be printed in the office of Aspect India, Further, these are not signed. Otherwise also, these facts do not decide the taxability of the transaction.

(g) Under section 14 of the Copyright Act, "copyright" means the exclusive right to do or authorize the doing of any of the specified acts in respect of a work. Therefore, only the copyright holder possesses the "exclusive right" to do the specified acts in respect of a work and only he can authorize someone else to do those acts. No one else can exercise the specified acts. The channel partner is granted the right to give on commercial rental (i.e. right to sub-license) a copy of the computer program. The owner of the copyright can assign either wholly or partially such rights to any other person. There is no requirement under the Copyright law that the owner of rights should grant exclusive right to the other to do all or any of the acts to which the author/ owner is having exclusive rights.

22.1. The Ld. D.R. pointed out that the Government of India Publication "Handbook on Copyright Law" states that the expression "reproduce" as used in Section 14(a)(i) of the Copyright Act, mean the right to make " one or more copies". Therefore, he contended that there is no requirement that the reproduction take place only when mass copies are produced or only if these are produced for sale or commercial exploitation. Under the End User Agreement, the licensee has been given right to make one copy of the software for archival and backup purposes (clause 3(iii) of the sample agreement filed). They are also assigned other intellectual property rights. These rights are granted to allow the use of software and also for archival purpose.

22.2. In support of his arguments, he heavily relied upon the decision of Hon'ble Karnataka High Court in the case of CIT (International Taxation) v.

Samsung Electronics Co. Ltd. (203 Taxmann 477 , Kar HC) and the decision of ITAT Delhi Bench in the case of Gracemac Corpn. v. Asstt. DIT (42 SOT 550).

23. He submitted that in view of the clarificatory amendment to section 9(1)(vi)(c) of the Act made by the Finance Act 2012, the income from licensing of software is taxable as royalty under the provisions of section 9(1)(vi)(c) of the Act. He also relied on the following decisions of the Hon'ble Jurisdictional High Court:

- Nokia Networks OY (253 CTR 471, paragraph 23 of the order)
- Infrasoft Ltd (SUPRA)

24. Further, he submitted that the second proviso to Section 9(1)(vi)(c) of the Act excludes the applicability of clause (vi) to section 9(1) to so much of the income by way of royalty as consists of lump sum payment made by resident person for the transfer of all or any rights (including granting of a license) in respect of 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. This proviso explicitly carves out the taxation of income from the specific type of software supply only. Thus, income from supply of software through any other arrangement is taxable as royalty. Otherwise the second proviso would become redundant.

25. The Ld.CIT, D.R. argued that Section 115A of the Act which deals in tax on dividends, royalty and technical service fee in the case of foreign companies provides for tax rates on royalty or FTS. Section 115A refers to "copyright in any book or "in respect of any computer software". This indicates that computer software is very much covered under the definition of "royalty". Combined reading of section 9(1)(vi) including its second proviso and section

115A leaves no doubt that consideration for supply / licensing of software is taxable as royalty under the Act.

26. The Learned CIT DR submitted that the taxability of revenue from all sources is required to be decided based on the provisions of the Income Tax Act only, since the assessee is not eligible to claim the benefits of tax treaty in view of specific provisions in Article 24 "Limitation of Benefits" of the Indian DTAA with the USA. Article 24 of the Tax Treaty denies the benefits of the tax treaty to tax resident of the USA if such tax payer does not satisfy the requirements of Article 24 and in the instant case, it was submitted that the assessee is a wholly owned subsidiary of a Cayman Islands based company (page 20 of PB I) therefore the condition for eligibility of benefits is not satisfied. We find that this fact is not emanating from the orders of the lower authorities and further that this issue was not considered by any one of the lower authorities. Hence, we have not considered it necessary to adjudicate this issue.

27. He further submitted that a tax treaty is interpreted on the basis of the definition of the terms available in the treaty. The definition of terms is normally given in the respective Articles. Article 3 of the Tax treaty deals with definition of general terms used in the Tax Treaty. Paragraph 2 of Article 3 provides rules for interpretation of undefined terms. Referring to Article 3(2) of the Tax Treaty, he submitted that any term not defined in the Convention shall unless the context otherwise requires, have the meaning which it has under the laws of that State concerning tax to which the Convention applies.

28. He referred to Article 2 of the Tax treaty and submitted that it lists the taxes to which the convention applies. In India, the Tax Treaty with USA applies only to Income tax. Therefore, Tax Treaty with the USA only authorizes recourse to the Income Tax Act for finding out the meaning of undefined terms.

No support from Copyright Act, Sale of Goods Act or even other tax laws like Sales Tax can be made. Therefore, the concept of "copyrighted article" borrowed from the proposed law of the US or the commentary to the OECD Model Tax Convention in the ITAT decision (confirmed by the High Court) in the cases of Ericsson/ Nokia etc. is clearly not authorized under the Tax Treaty. Therefore, these decisions are distinguished and not applicable in the present case. The term "copyrighted article" is not defined or recognized in the Act. The expression "use of, or the right to use any copyright" is not defined in the tax treaties. The term used in the expression are now explicitly defined in explanation 4 to Section 9(1)(vi) of the Act. Transfer of all or any rights in respect of any right , property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license.)

29. He argued that reliance should not be placed on the OECD commentary for interpretation of Indian tax law/ treaty.

30. Further, relying on the assessment order he submitted that the revenue received on account of licensing of software would qualify as "process royalty" and "equipment royalty" taxable under the Act and the Tax Treaty.

31. In rejoinder, the learned Counsel for the assessee submitted as under:

(a) Software is not embedded in the hardware: The software and hardware are integral parts of the 'solutions" which the Appellant sells to its customers and channel partners in India. The software cannot function without the hardware. They are shipped separately only for custom purposes. The learned DR alleged that invoices at page 239 to 252 shows that the software is not embedded in hardware. It is submitted that the software and hardware are shipped separately for custom purposes and all these invoices show sale of both hardware and software which is essential for the solution to work.

(b) Some customers purchased license for the software from the assessee without purchase of the equipment: Only 8 customers out of a total of 63 customers have been sold software exclusively, implying majority of customers having purchased both hardware and software. Even this minority pertains to certain upgrades etc. which have been provided at cost. A selective sampling by the learned DR cannot be the basis to argue that software is being sold independently. Even otherwise, the question of whether software is embedded or not, becomes academic as in either situation the jurisdictional High Court in Nokia, Ericsson and Infrasoft decisions (SUPRA) has held that the payment cannot be royalty.

(c) Software is not sold but licensed: This issue has been dealt by the Hon'ble Delhi High Court in the case of Infrasoft, where also the software was licensed- Para 6 of the ruling.

(d) Equipment is different from software- The learned AO himself in the assessment order held that the software/ solution to be equipment (page 21 of the assessment order enclosed in appeal set).

(e) No transfer of title: The Learned DR having submitted that the "title in software always remains with the Aspect Software Inc". If that be the case, how can there be any transfer of copyright, which is pre-requisite for sale to be taxed as royalty under the treaty?

(f) Amendments to the definition of the royalty under the Act to be read into the Tax Treaty : The learned DR has sought to distinguish the Hon'ble Delhi High Court ruling in the case of Ericsson and Nokia on the ground that definition of the term "use of , or right to use any copyright" is not defined in the Tax Treaty and hence the definitions must be taken from the amended version of section 9 of the Act following Article 3 of the Tax Treaty. This issue has been considered by coordinate Bench in the case of WNS North America Inc vs. ADIT (ITA No 8621/ Mum/ 2010) where in the Hon'ble ITAT has held that though the DTAA provides that the laws in force in India shall govern the taxation of income, if however a particular term has been specifically defined in the Treaty, the amendment to the definition of such term under the Act would have no bearing on the interpretation of such term in the context of the Convention.

(g) The Infrasoft ruling has very clearly considered the position post the retrospective amendment and still held software to be not taxable as royalty under the treaty following the precedent laid down in case of Ericsson ruling.

(h) Regarding the Learned DR's reliance on the Gracemac ruling, it is respectfully submitted that the ruling was pronounced on shrink wrapped software. In the present case, the software is not shrink wrapped software. Hence, this decision cannot be applied by the Learned DR. Further, the ratio of the Gracemac ruling now stands overruled by the Delhi High Court in the case of Infrasoft.

32. We have heard rival contentions at length. Both parties have filed detailed submissions and other materials. We have perused all the materials on record. The case laws cited are also considered. On a careful consideration of all the arguments, case laws and the material on record, we hold as follows.

33. For the subject AY under appeal, the assessee has earned revenue from licensing of software and supply of "contact solutions" to the customers in India which is a combination of software and the compatible hardware that enables the customers to better manage customer interactions via voice, email, web and fax. All the contact solutions are manufactured outside India in USA

and the supplies are made from outside India to various customers on Ex work/ FOB basis. The title and risk is passed outside India on shipment.

34. For the year under appeal, the assessee has contracts with 63 customers in India for supply of contact solutions and licensing of embedded software. The products are sold to customers in two ways: (i) directly to end users and (ii) through channel partners (i.e. resellers and distributors). Further, 8 out of 63 customers have been sold software exclusively, implying a majority of customers having purchased both hardware and software. Sample copies of the agreement with the end user and the channel partners along with invoices have been filed before us.

35. Considering the business model of the assessee with respect to supply/ licensing of software, we have considered the following sample agreements relied by both the parties during the course of the hearing:

- Agreement between Aspect US and Infovision Information Services (P) Ltd ('end user customer') -page 83 to 95 of PB-I.
- Channel sales agreement between Aspect Software Inc and C.S. Infocomm Pvt. Ltd ('Channel Partner'), Mumbai- page 96 to 106 of PB-I

The relevant clauses from both the above agreements are extracted for ready reference:

End User Equipment/Software/Services Agreement between Aspect Software Inc., USA and Infovision Information Services Pvt.Ltd., India dated 19.12.2006

Clause 3- License (Page 83 and 84 of PB-I)

<u>Aspect hereby grants to customer and customer hereby accepts from Aspect, an indefinite, non-exclusive and non-transferable right to use the software and Ancillary programs ('License")</u> subject to the provisions specified below. Customer may

(i) Use up to the number of licenses specified on the quotation solely for its own internal business use (which shall not include use as an application service provider or any other renting, leasing, sublicensing or other utilization of the **software or Ancillary programs** to or by anyone other than by customer or its agents or Affiliates), **only on the hardware authorized in the documentation**, and only within the Territory;

(ii) Use the Ancillary programs only in combination with the Equipment and software and solely for purposes of installing and/or operating the equipment and software in accordance with the Documentation;

(iii) Make one copy of the software and Ancillary programs in machine-readable, object code from only for non productive archival and backup purposes or to replace a worn or defective copy.

Customer will not decompile, disassemble or reverse engineer the Products, except as and be the extent expressly authorized by applicable law. The interface information necessary to achieve interoperability of the Products will be provided by Aspect on request and upon Customer's payment of Aspect's reasonable costs and expenses for procuring and supplying such information. Customer shall not at any time remove, modify, obscure or otherwise alter in full or in part any copyright or other proprietary notice(s) of Aspect's or a third party as the same may be contained in or appear on the originally procured Product, or any copy or component thereof.

Definitions – (Page 83 of PB-I)

Product- "Products" means equipment, software and Ancillary program(s) as applicable.

Equipment- "Equipment" means Aspect proprietary hardware and third party hardware purchased from Aspect as specified on a Quotation.

Software- "Software" means Aspect's proprietary computer program in object code form described on a Quotation. Software (and Ancillary Programs where applicable) also includes all fixes and new releases provided by Aspect (or its representatives) to customer, as well as copies thereof.

Ancillary Programs- "Ancillary Programs" means a third party computer program(s) in object code form which is provided by Aspect for use with the software and Equipment.

Clause 8- Termination clause (Page 90 of PB-I)

Aspect may at its discretion terminate the license by written notice upon happening of following events; (i) if the customer breaches material license provision herein; or (ii) the customer fails to cure any other material breach of the terms of this agreement with 30 days after receipt of written notice from Aspect.

Upon expiry or termination of the license, the customer shall immediately return or destroy the software and ancillary programs and all copies thereof as directed by Aspect.

Clause 10- Ownership rights (Page 91 of PB-I)

All right, title and interest in and to any software, ancillary Programs and Services deliverables provided hereunder, including, without limitation, all intellectual property and other proprietary rights associated therewith ('IP Materials") shall vest in and be held by Aspect and/or its third party licensors. Such rights shall include, without limitation, as rights in patents, copyrights, trade secrets, trademarks, inventions and mask works.

Customer shall, at Aspect's request and expense, promptly take all such action and execute such further documents and instruments as are necessary to vest full title in the IP Materials in Aspect. Customer's limited right to use such IP Materials shall be also governed by the licensing and confidentiality provisions of this Agreement.

Clause 5- Payment and Shipment terms (Page 85 of PB-I)

- All payments accruing under this Agreement for products or services shall be made in United States Dollars;
- Shipment shall be FOB Aspect's shipping location, with title to the Equipment and risk of loss to the products passing to Customer upon shipment

Channel Sales Agreement dt. 12th October, 2005 between Aspect Software Inc., USA and CS Infocomm Pvt.Ltd., India

DEFINITIONS

(k) "End User" means Partner's customers who are end-users of Product within the Territory.

(l) "End User Agreement" means that certain written agreement entered into by and between Partner and End-User, pursuant to which End User shall procure Product and Services directly from Partner.

(m) "Equipment" means Concerto's proprietary equipment and third party equipment for which partner has received specific written authorization from Concerto and which is purchased from Concerto and specified on a Quotation.

(q) "IP Materials" means any Software and Ancillary Programs (including, without limitation, Service deliverables and Documentation) and all Concerto Information and proprietary material. IP Materials shall include, without limitation, all programs, program listings, programming tools, procedures, reports, and drawings (except to the extent that such reports or drawing contain End-User specific data or information).

(r) "Marks" means trademarks, service marks, logos or other words or symbols identifying the Products or Concerto's business including circuit layouts, invention and mask works.

(y) "Product(s)" means the Equipment, Software, Ancillary programs and Documentation. Upon notice to Partner, Concerto may add new products to its offerings or delete existing products subject to Partner's binding Product orders accepted by Concerto prior to the date of such notice. Partner shall become authorized to distribute and service only those new Product offerings for which Partner has received authorization.

(bb) “Services” means System Implementation Services, Training Services, Professional/Enterprise Solutions Services, Support (Maintenance) Services, Equipment Relocation Services, and/or Time & Materials Services (each of which is described more fully in the Guide).

(cc) “Software” means Concerto’s proprietary computer programs, in object code form, for which Partner has received appropriate Documentation, fixes, modifications, updates, upgrades, new versions and/or copies of the Software provided to Partner pursuant to Concerto’s obligations under this Agreement, including, without limitation, Service deliverables provided hereunder.

(c) “Software Sub-Licensing” :-

(i) Partner shall promote, solicit and accept orders for the Software and Ancillary Programs subject to the provisions of this Agreement, specifically including without limitation, the provisions set forth in the guide. Partner shall be deemed to be the Sub-Licensor, pursuant to the provisions of this Agreement, of any software provided to the end user. Partner shall expressly detail in any quotation to an End-User and, as may be applicable, in any End-User Agreement, the Software and Ancillary Programs being quoted or furnished.

(ii) The Software License terms between Partner and End-User, as same shall be considered in every End-User Agreement and shall govern the End User’s use of the Software and Ancillary Programme, shall be no less restrictive than the Minimum License Terms. Concerto may, in its sole discretion, modify or replace the Minimum License Terms at any time, in whole or in part, upon notice to Partner. Partner shall not be required to retroactively apply any such modification to the Minimum License Terms. Partner shall also apply all applicable sub-licensing procedures as same appear in the Guide as of the effective date of the specific End-User Agreement. To the maximum extent permitted by local law, the Software License shall be no less restrictive than the Minimum License Terms: provided, however, that Partner shall be entitled to use terms which are less restrictive than the Minimum License Terms if, and only to the extent, required to comply with local law in the applicable country within the Territory.

(iii) In no event shall Partner license or deliver to any End-User or other third party any source code for the Software or Ancillary Programs, in whole or in part.

(iv) Partner recognizes that the Ancillary Programs are licensed to Concerto by Third Party Licensor(s) and that the functionality of the Software relies in part on such Ancillary Programs. Partner further recognizes that Third Party Licensors may, from time to time, impose the restrictions on the sale, license or use of such Ancillary Programs within the Territory. Concerto shall notify Partner of any such third party actions, but shall have no liability whatsoever to Partner on such basis. Each Third-Party Licensor is a direct and intended third party beneficiary of this Agreement to the extent the Agreement relates to the Ancillary Programs, and may enforce the Agreement directly against Partner to such extent, provided, however that no Third-Party Licensor shall be liable to the Partner for any general, special, direct, indirect, consequential, incidental or other damages arising out of or relating to the Ancillary Programs. Partner hereby acknowledges that each such Third-Party Licensor fully accepts such rights as a third party beneficiary of this Agreement and that such rights were irrevocable.

(v) Partner will effectively enforce against all its End-Users the Minimum License Terms, specifically including, without limitation, those provisions that affect proprietary or confidentiality rights of Concerto or its Third Party Licensors. If Partner learns that any End-User has breached any such provision, Partner will immediately notify Concerto and Partner shall take, at its expenses, all steps that may be available to enforce the Minimum License Terms, including availing itself of actions for seizure or injunctive relief. If Partner fails to take these steps in a timely and adequate manner. Concerto or its Third Party Licensors may take them in its own or Partner's name and at Partner's expense.

(vi) In the event Partner obtains or uses any item of Software and/or Ancillary Programs for its own internal use. Partner shall be deemed to be an End-User subject to the Minimum License Terms, in addition to the other applicable terms of this Agreement. In the event Partner obtains or uses any item of Software and/or Ancillary Programs for demonstration purposes such Software and Ancillary Programs shall be provided pursuant to, shall be subject to, and Partner hereby agrees to be bound by the Minimum License Terms except to the extent that they may conflict with the specific provisions contained in the main body of this Agreement.

<u>Orders and Delivery</u>

(b) Shipment & Delivery:

(i) Concerto will establish a shipment schedule for each Order which Concerto accepts from Partner.

(ii) Concerto will utilize its reasonable efforts to Deliver the Product ordered hereunder on the Delivery Date. Concerto shall be excused for delays in and/or failure of Delivery if such delay or failure is due to any causes beyond Concerto's reasonable control. Delivery of airway bills or other bills of lading before or after the Products arrive in the Territory will not affect the place or time of Delivery. Product to be delivered hereunder will be package appropriately for shipment in accordance with standard commercial practices.

(iii) Each Delivery shall be made F.O.B. origin, "Freight prepaid and add", with freight charges billed to Partner by Concerto. All shipping, insurance, and other related obligations shall be assumed by Partner at the time of Delivery. Partner will pay or reimburse. Concerto for any insurance, brokerage, handling, transportation, demurrage and other transport-related costs that Concerto may incur with respect to any Concerto assistance related to delivery, transport, or otherwise moving the Products from Concerto's distribution center to Partner, Concerto will separately identify all reimbursable costs in its Order confirmation or Invoice issued to Partner.

(iv) Concerto shall perform or cause to be performed at its factory its standard quality assurance test procedures on all Products to be delivered by Concerto hereunder. Product shall be deemed to have been accepted by Partner upon Delivery.

(v) Title to the Equipment and all risk of loss to the Products shall pass to Partner upon delivery to the common carrier. Partner, at its expense, shall insure all Equipment against risk of loss and damage until delivered to the destination stated in the order. Partner acknowledges that title to the Software and Ancillary Programs shall at all times remain vested in Concerto or its licensors and will not, under any circumstances, pass to Partner or its End-Users.

(vi) Partner may direct Concerto to make Delivery, on Partner's behalf, to a specific shipping agent in the United States for re-shipment, as applicable, within the Territory. Partner shall provide such special shipping instructions either in the Order or otherwise in writing to Concerto at least 30 days prior to the scheduled shipment date. In the absence of such special shipping instructions, Concerto shall select a common carrier on behalf of Partner, in no event shall Concerto be liable for shipment by common carrier nor shall such common carrier be construed to be an agent of Concerto.

36. From the above clauses, it is evident that what is sold to the end customer is a product comprising of both hardware and software. The software is not separately licensed. Further, Aspect US retains all the intellectual property rights in the software and the end user is merely provided with limited right to use the licensed product solely for internal use.

37. Further, the learned Counsel for the assessee has filed before us a comparative chart of the various clauses of the agreements in the case of the assessee and that of the Agreements in the case of Ericsson A.B and Infrasoft Ltd. (Supra). We are of the view in the light of the similarity of facts as it exists in the case of the assessee and that of the case of Ericsson A.B. and Infrasoft Ltd the issue relating to supply of "contact solutions" which comprises sale of hardware and license of embedded software to end customers is squarely covered in the favour of the assessee by the decision of the Hon'ble Delhi High Court in the case of DIT v. Ericsson A.B. (Supra).

38. In the case of Ericsson, the Hon'ble Delhi High Court was dealing with a question as to whether the Tribunal was justified in holding that the consideration for supply of software was not a payment by way of royalty, and hence was not assessable both under Sec.9(1)(vi) of the Act and the relevant clause of DTAA with Sweden. The facts of the aforesaid case were that the assessee company was incorporated in Sweden and was one of the leading suppliers of telecommunication equipment comprising of both, hardware and software. The assessee company had entered into agreements with ten cellular operators in India for supply of hardware and software. The Assessing Officer was of the view that the income of the assessee was taxable in India, both, under the Income-tax Act, 1961 as well as under the treaty between India and Sweden. He held that it was business income and Assessee had a PE in India. The CIT(A) held that the receipts in respect of license to use software which is

part of the hardware alone could be taxed in India as royalty. The Assessee argued before the Tribunal that the payment made by the assessee for the use of software in the equipment does not amount to royalty. The Tribunal in the aforesaid context examined the issue as to whether the payment is for a copyright or for a copyrighted article. If it 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. If the payment is really for a copyrighted article, then it only represents the purchase price of the article and, therefore, cannot be considered as royalty either under the Act or under the DTAA. The Tribunal after referring to definition of Royalty under the Act and the definition copyright under the Copyright Act, 1957 held that what was sold by the non- resident was a copyrighted article and payment to the non -resident was not for copyright. On further appeal by the Revenue, the Hon'ble Delhi High Court held that income did not accrue to the non-resident by virtue of a business connection in India and therefore the question of the Non-resident having a permanent establishment in India did not arise for consideration at all. On the issue whether the payment to the non resident was of the nature of royalty which could be brought to tax in India, the Hon'ble Delhi High Court held as follows:

"*WHETHER THE INCOME FROM THE SUPPLY CONTRACT CAN BE TREATED AS 'ROYALTY' UNDER SECTION 9(1)(vi) OF THE ACT:*

50. Section 9 (1) (i) of the Act which deals with the taxability of "royalty income" reads as under:-

"Section 9 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA.

(1) The following incomes shall be deemed to accrue or arise in India :-

(i) All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India"

51. The submission of Mr. Prasaran, learned ASG was that software part of the equipment supply would attract royalty as copy right of the said software programme still vests with the assessee. Therefore, payments made for the licence to use the software programme give rise to "royalty" for the purposes of both the Income-Tax Act as well as DTAA entered into between Sweden and India. Referring to Explanation-II (v) to Section ((1) (vi) of the Act as well as Article 13, para-3 of DTAA, it was argued that for the purposes of Income-Tax law, royalty is essentially a payment received as consideration for the use or right to use a particular integral property right, whether partially or entirely.

52. We find that the Tribunal has held that there was no payment towards any royalty and this conclusion is based on the following reasoning:-

(i) Payment made by the cellular operator cannot be characterized as royalty either under the Income Tax Act or under the DTAA.

(ii) The operator has not been given any of the seven rights under S.14 (a) (i) to (vii) of the Copyright Act, 1957 and, therefore what is transferred is not a copyright but actually a copyrighted article

(iii) The cellular operator cannot commercially exploit the software and therefore a copyright is not transferred.

(iv) Further, the parties to the agreement have not agreed upon a separate price for the software and therefore it is not open for the income tax authorities to split the same and consider part of the payment for software to be royalty

(v) The bill of entry for importing of goods shows that the price has been separately mentioned for software and that this was only for the purposes of customs. There is no evidence to show that the assessee was a party to the fixation of value for the customs duty purposes

(vi) The software provided under the contract is goods and therefore no royalty can be said to be paid for it.

53. Mr. Prasaran, countered the aforesaid reasoning arguing that Clause 20 of the Supply Contract uses the term "licence" and the same term is used in the *context of software throughout the three Agreements, indicating that it is not an outright sale of goods, or a full transfer of rights from the assessee to the Indian company. He also submitted that the software is a computer programme, which is treated differently from a book, not only in the Copyright Act, 1957 but also the Income Tax Act itself. His submission was that Section 52(1) (aa) of the Copyright Act only deems that certain acts will not to amount to infringement in the light of various concerns, where otherwise such acts would amount to infringement under Section 51 of the Copyright Act. The provision cannot by itself be used to hold that no right exists in the first place, since the scope of the right has to be understood only from the provisions of Section 14 of the Copyright Act, 1957. He also argued that the ITAT has misinterpreted the provisions of the DTAA, specifically Article 13, para 3 of the DTAA (Article 12, para 3 of the Model Convention) which defines royalties to mean "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work". The ITAT, it was submitted, has not appreciated that the royalty is for the use or right to use any copyright. According to him, since title of the software continued to vest with the assessee as provided in clause 20.2 of the Supply Agreement and the assessee was free to grant non exclusive licenses to other parties, it follow that there was no full time transfer of copyright but it was only a case of right to use the software, and thus payment for use of software is to be treated as royalty. He further argued that reference to OECD Commentary was not apposite as it could not be used to interpret the scope of the relevant provisions of DTAA.*

54. It is difficult to accept the aforesaid submissions in the facts of the present case. We have already held above that the assessee did not have any business connection in India. We have also held that the supply of equipment in question was in the nature of supply of goods. Therefore, this issue is to be examined keeping in view these findings. Moreover, another finding of fact is recorded by *the Tribunal that the Cellular Operator did not acquire any of the copyrights referred to in Section 14 (b) of the Copyright Act, 1957.*

55. Once we proceed on the basis of aforesaid factual findings, it is difficult to hold that payment made to the assessee was in the nature of royalty either under the Income-Tax Act or under the DTAA. We have to keep in mind what was sold by the assessee to the Indian customers was a GSM which consisted both of the hardware as well as the software, therefore, the Tribunal is right in holding that it was not permissible for the Revenue to assess the same under two different articles. The software that was loaded on the hardware did not have any independent existence. The software supply is an integral part of the GSM mobile telephone system and is used by the cellular operator for providing the cellular services to its customers. There could not be any independent use of such software. The software is embodied in the system and the revenue accepts that it could not be used independently. This software merely facilitates the functioning of the equipment and is an integral part thereof. On these facts, it would be useful to refer to the judgment of the Supreme Court in TATA Consultancy Services v. State of Andhra Pradesh, 271 ITR 401 , wherein the Apex Court held that software which is incorporated on a media would be goods and, therefore, liable to sales tax. Following discussion in this behalf is required to be noted:-

"In our view, the term "goods" as used in Article 366(12) of the Constitution of India and as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. (supra). A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that 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. Even intellectual property, once it is put on to a media,

whether it be in the form of books or canvas (In case of painting) or computer discs or cassettes, and marketed would become "goods". We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of paintings or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc. The software programmes have all these attributes."

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"In Advent Systems Ltd. v. Unisys Corpn, 925 F. 2d 670 (3rd Cir. 1991), relied on by Mr. Sorabjee, the court was concerned with interpretation of uniform civil code which "applied to transactions in goods". The goods therein were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". It was held :

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.

That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

56. A fortiorari when the assessee supplies the software which is incorporated on a CD, it has supplied tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty.

57. It is also to be borne in mind that the supply contract cannot be separated into two viz. hardware and software. We would like to refer the judgment of Supreme Court in CIT v. Sundwiger EMFG Co., 266 ITR 110 wherein it was held:

"A plain and cumulative reading of the terms and conditions of the contract entered into between the principal to principal i.e., foreign company and Midhani i.e., preamble of the contract, Part-I and II of the contract and also the separate agreement, as referred to above, would clearly show that it was one and the same transaction. One cannot be read in isolation of the other. The services rendered by the experts and the payments made towards the same was part and parcel of the sale consideration and the same cannot be severed and treated as a business income of the non-resident company for the services rendered by them in erection of the machinery in Midhani unit at Hyderabad.

Therefore, the contention of the Revenue that as the amounts reimbursed by Midhani under a separate contract for the technical services rendered by a non-resident company, it must be deemed that there was a "business connection", and it attracts the provisions of Section 9(1)(vii) of the Income Tax Act cannot be accepted and the judgments relied upon by the Revenue are the cases where there was a separate agreement for the purpose of technical services to be rendered by a foreign company, which is not connected for the fulfillment of the main contract entered into principal to principal. This is not one such case and *thus the contention of the Revenue cannot be accepted in the circumstances and nature of the terms of the contract of this case."*

58. No doubt, in an annexure to the Supply Contract the lump sum price is bifurcated in two components, viz., the consideration for the supply of the equipment and for the supply of the software. However, it was argued by the learned counsel for the assessee that this separate specification of the hardware/software supply was necessary because of the differential customs duty payable.

59. Be as it may, in order to qualify as royalty payment, within the meaning of Section 9(1) (vi) and particularly clause (v) of Explanation-II thereto, it is necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copy right of a literary, artistic or scientific work. Section 2 (o) of the Copyright Act makes it clear that a computer programme is to be regarded as a "literary work". Thus, in order to treat the consideration paid by the cellular operator as royalty, it is to be established that the cellular operator, by making such payment, obtains all or any of the copyright rights of such literary work. In the presence case, this has not been established. It is not even the case of the Revenue that any right contemplated under Section 14 of the Copyright Act, 1957 stood vested in this cellular operator as a consequence of Article 20 of the Supply Contract. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article".

60. Mr. Dastur is right in this submission which is based on the commentary on the OECD Model Convention. Such a distinction has been accepted in a recent ruling of the Authority for Advance Ruling (AAR) in Dassault Systems KK 229 CTR 125. We also find force in the submission of Mr. Dastur that even assuming the payment made by the cellular operator is regarded as a payment by way of royalty as defined in Explanation 2 below Section 9 (1) (vi), nevertheless, it can never be regarded as royalty within the meaning of the said term in article 13, para 3 of the DTAA. This is so because the definition in the DTAA is narrower *than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case.*

61. We thus hold that payment received by the assessee was towards the title and GSM system of which software was an inseparable parts incapable of independent use and it was a contract for supply of goods. Therefore, no part of the payment therefore can be classified as payment towards royalty."

39. Similar view is expressed by the Hon'ble Jurisdictional High Court in the case of Nokia Networks OY (supra).

40. As far as the cases where only the software is separately licensed (i.e. with respect to 8 out of 63 customers to whom the assessee has licensed only the software), the issue is squarely covered by the decision of the Hon'ble Jurisdictional High Court in the case of Infrasoft Ltd. (supra), wherein their Lordships held as under:—

"*86. The Licensing Agreement shows that the license is non-exclusive, non-transferable and the software has to be uses in accordance with the agreement. Only one copy of the software is being supplied for each site. The licensee is permitted to make only one copy of the software and associated support information and that also for backup purposes. It is also stipulated that the copy so made shall include Infrasoft's copyright and other proprietary notices. All copies of the Software are the exclusive property of Infrasoft. The Software includes a licence authorisation device, which restricts the use of the Software. The software is to be used only for Licensee's own business as defined within the Infrasoft Licence Schedule. Without the consent of the Assessee the software cannot be loaned, rented, sold, sublicensed or transferred to any third party or* *used by any parent, subsidiary or affiliated entity of Licensee or used for the operation of a service bureau or for data processing. The Licensee is further restricted from making copies, decompile, disassemble or reverse-engineer the Software without Infrasoft's written consent. The Software contains a mechanism which Infrasoft may activate to deny the Licensee use of the Software in the event that the Licensee is in breach of payment terms or any other provisions of this Agreement. All copyrights and intellectual property rights in and to the Software, and copies made by Licensee, are owned by or duly licensed to Infrasoft.*

87. In order to qualify as royalty payment, it is necessary to establish that there is transfer of all or any rights (including the granting of any licence) in respect of copyright of a literary, artistic or scientific work. In order to treat the consideration paid by the Licensee as royalty, it is to be established that the licensee, by making such payment, obtains all or any of the copyright rights of such literary work. Distinction has to be made between the acquisition of a "copyright right" and a copyrighted article". Copyright is distinct from the material object, copyrighted. Copyright is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. Just because one has the copyrighted article, it does not follow that one has also the copyright in it. It does not amount to transfer of all or any right including licence in respect of copyright. Copyright or even right to use copyright is distinguishable from sale consideration paid for "copyrighted" article. This sale consideration is for purchase of goods and is not royalty.

88. The license granted by the Assessee is limited to those necessary to enable the licensee to operate the program. The rights transferred are specific to the nature of computer programs. Copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilizing the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the *user, should be disregarded in analyzing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business income in accordance with Article 7.*

89. There is a clear distinction between royalty paid on transfer of copyright rights and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the royalty definition. Viewed from this angle, a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of DTAA. Where the purpose of the licence or the transaction is only to restrict use of the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. The parting of intellectual property rights inherent in and attached to the software product in favour of the licensee/customer is what is contemplated by the Treaty. Merely authorizing or enabling a customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to transfer of rights in relation to copyright or conferment of the right of using the copyright. The transfer of rights in or over copyright or the conferment of the right of use of copyright implies that the transferee/licensee should acquire rights either in entirety or partially co-extensive with the owner/ transferor who divests himself of the rights he possesses pro-tanto."

41. Before us, the learned counsel for the Assessee as well as the learned D.R. relied on several decisions of the High Court and Tribunal rendered on the subject. These decisions are not being considered as the issue is extensively dealt by the Hon'ble Jurisdictional High court in the cases of M/s Ericsson

A.B. and Infrasoft Ltd (supra) which are binding on this Tribunal. We observe that all the arguments put forth by the Revenue and the assessee are considered and answered in these decisions. Further, the Delhi High Court in Infrasoft has expressed its disagreement with the view taken by the Karnataka High Court in the case of Samsung Electronics Co Ltd. Hence, the decisions relied by the learned CIT-DR in the case of Samsung Electronics and Gracemac Corporation (supra) does not help the case of the Revenue, as we are under the Jurisdiction of the Hon'ble Delhi High Court.

42. In view of the above, respectfully following the decision of Hon'ble Jurisdictional High Court in the case of Ericsson A.B. (supra) and Infrasoft Ltd. (supra), we hold that the consideration received by the Assessee for supply of product along with license of software to End user is not royalty under Article 12 of the Tax Treaty. Even where the software is separately licensed without supply of hardware to the end users (i.e. eight out of 63 customers), we are of the view that the terms of license agreement is similar to the facts of Infrasoft Ltd (Supra). Accordingly, we hold that there was no transfer of any right in respect of copyright by the assessee and it was a case of mere transfer of a copyrighted article. The payment is for a copyrighted article and represents the purchase price of an article. Hence, the payment for the same is not in the nature of royalty under Article 12 of the Tax Treaty. The receipts would constitute business receipts in the hands of the Assessee and is to be assessed as business income subject to assessee having business connection/ PE in India as per adjudication on Ground No 5.

Ground No 3 and 4

43. The above grounds deal with revenue earned from rendering of implementation services and maintenance services to customers in India as "Royalty/ FTS/ FIS" under the Act and the Tax Treaty

44. Aspect US provides the following services which enable the call center companies to better manage customer interactions via, email, web and fax:

(i) Implementation services – These services include providing specifications of the system server and environment conditions for adaption of the system (hardware and software). These services are provided as under:
   - Where the supply of the product is directly by Aspect US, the services are provided remotely by Aspect US to the end customer
   - Where the supply of the product is made by Aspect US through Channel Partners, the services are provided by Channel Partners
   - Where the end customer or Channel Partner insist on providing onsite support, ATC, the subsidiary based out of Bangalore provides the support.

(ii) Maintenance services – These services are provided for a period of one year as a part of licensing of software and sale of hardware and can be renewed each year thereafter on payment of maintenance service fee. These services entails resolving problems or bugs in the product which results in its functioning effectively, providing new releases and upgrades of the software, providing help desk services. These services are performed outside India by the Appellant and only in exceptional cases, where the end customer/ channel Partners insist on providing onsite support, ATC provides the support.

(iii) Professional Services- These services include telephone, e-mail and web support, software support by accessing site configuration to determine revision levels for the authorized software partners, software upgrades etc. It also includes wide range of classroom and computer based courses as well as custom courses tailored to meet unique training, schedule and location requirements that focus on the application and functionality of Aspect products. Revenue from professional services has been offered to tax by the assessee as FIS under Article 12 of the Tax Treaty.

45. The AO rejected the contentions of the assessee that the services in question were performed outside India and that only in exceptional cases the end customer and channel partners insist on providing onsite support and ACT provides the support. The AO was of the view that the implementation services cannot exist without transfer of software license and hence, these services are inextricably linked with the grant of software licenses. The AO has taxed the revenues from these services as 'Fees for Technical Services" under Sec. 9(1)(vii) of the Act and as FIS under the Tax Treaty. Similarly for maintenance services, the AO was of the view that they are FTS under the Act and FIS under the Tax Treaty for the reason that there would not have been any maintenance expenses if the soft ware in question is shrink wrapped soft ware. The action of the AO was confirmed by the DRP.

46. The learned Counsel for the assessee submitted that the implementation services have been accepted by the AO to be incidental to the supply of software. Implementation services would acquire the nature of software itself and does not qualify as FIS under Article 12(4)(a) of the Tax Treaty since the supply of software itself does not qualify as royalty. Further, the implementation services would also not fall within the ambit of Article 12(4)(b) of the Tax Treaty as these services do not make available technology, skill or experience, etc to the end users i.e. such service are not geared towards enabling the end user's personnel to undertake similar activities independently in future.

47. On maintenance services, it was argued that these services are provided remotely to the end users and only in rare cases, where end users/ channel partners insist on onsite support, the Indian AEs of the assessee provides the

same. The services are not rendered in India and hence not taxable u/s 9(1)(vii) of the Act.

48. Without prejudice to the above argument, it was submitted that the revenues earned from maintenance services are not taxable as FIS as these services do not make available technology, skill or experience to the end user as per Article 12(4)(b) of the Tax Treaty. Maintenance services provided under an annual maintenance contract basically include resolving day to day problems and such service do not enable the customer to apply the technology independently without recourse to the service provider. Further, these services also includes provision of upgrades and new releases which do not fall within the definition of FIS under the Tax Treaty, since there is no "development and transfer" of these updates. The software is not developed and customized for one person but for all the software users at large. Thus, they are in the nature of software itself and since the payment for software is not taxable in India, the revenue from maintenance services ought not to be taxed in India.
Reliance is placed on a number of case laws including:

- Raymonds (80 TTJ 120 , Mum ITAT)
- DCIT vs. PanamDat International Systems Inc (103 TTJ 861)
- CIT vs. Navbharat Ferro Alloys Ltd (244 ITR 261, AP HC)
- DCIT vs ITC Ltd (82 ITD 239 , Kol ITAT)
- CIT vs. Hindustan Shipyard Ltd.(109 ITR 158, AP HC)
- CIT vs. Sundwinger Empg & Co. (262 ITR 110, AP HC)
- Guy Carpenter & Co.Ltd. (346 ITR 504, Delhi HC)
- Debeers India Minerals Ltd. (346 ITR 467, Kar HC)

49. The learned CIT –DR relied on the orders passed by the AO and submitted that the definition and scope of various support services provided by Aspect India to customers of Aspect Inc is available as given below:

- Services (Clause 1 on page 83 of PB-I)
- Support services: Implementation (page 86 of PB-I); Maintenance support (page 86 and 87); education services (page 88); professional services (page 88) and Time and Remedies (page 88).

50. The learned Counsel for the assessee has claimed that 90% of services to customers are provided by Channel Partners and balance 10% are provided by the assessee to customers. On this issue the Ld.D.R. pointed out that the agreement with the Channel partners defines services "means system implementation services, training services, professional, enterprise solution services, support (maintenance services), equipment relocation services, and/ or time and material services" (clause1 (bb) on page 97 of PB-I). Further he referred to Clause 3(b) and 3(c) on page 97 of the PB-I and submitted that Channel Partners obligations include equipment and service sale. Regarding pricing of the products and related services, the Partner will establish the prices that it charges to the end user within the territory for the products and related services distributed by the Partner. This suggests that 90% of the services are provided by Channel Sales Partner. Implementation and maintenance services are technical services and these services can only be provided by employees of channel sales partners which in fact are provided by employees of Aspect India. The description of maintenance services indicate that such services can only be provided through trained personnel of customers. While providing the services through the involvement of customers, Aspect India in fact makes available the services to Channel sales partner and customers.

51. He submitted that, in the present case, available facts explicitly indicate that maintenance services encompasses providing new release of software, provide tracking tool that enable the customer to track the performance of

equipments and software, provide self help environment, support to named and trained personnel. The Ld.D.R. contended that these services make available technical knowledge, experience and skill and Know how. He further submitted that the implementation and maintenance services are not independent of licensing of software. Hence, the payments are in the nature of fee for included services under the provisions of paragraph 4(a) of Article 12. These services are ancillary and subsidiary to the application or enjoyment of the right to property or information for which a payment described in paragraph 3(a) is received. It was also submitted that in case, the Hon'ble Tribunal takes the view that the payments are not in the nature of FIS then provisions of service PE applies and entire revenue is taxable as business income as all the revenue earned is on account of services provided by Aspect India or employees of the assessee in India.

52. We have heard both the parties at length and perused the relevant clauses of the agreement which deals with the above services. "Services" have been defined in the agreement "to include installation services, maintenance services, education services, professional services and T&M services, all as hereinafter defined, and any other services provided to Customer by or on behalf of Aspect, together with the related deliverables provided under services".

53. The revenue earned by the assessee from provision of education and professional services has been offered to tax in the return of income filed for the subject AY. The AO has now brought to tax the revenue earned from implementation service and maintenance service to tax.

54. Under the provisions of Sec 9(1)(vi)/(vii) of the Act, the revenue earned from the above services may qualify as royalty/ FTS. However, under Article 12

(4) of the Tax Treaty, the payments would qualify as “FIS” if the payment is for rendering of any technical or consultancy services, if such services:

a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or
b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

55. The term make available is not defined under the Tax Treaty. The Memorandum of Understanding (‘MoU’) to the Tax Treaty explains the term as under :-

"Generally speaking, technology will be considered "made available" when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not *per se* mean that technical knowledge, skills etc. are made available to the person purchasing the service, within the meaning of paragraph 4(*b*). Similarly the use of a product which embodies technology shall not *per se* be considered to make the technology available".

56. In the present case, the undisputed fact is that the implementation service is inextricably and essentially linked to the supply of software. In view of our decision in Ground No 2 that the supply of software is not taxable as “royalty” under the Tax Treaty, the provision contained in clause (a) to Article 12 (4) would not apply to both Implementation and maintenance services. Further there is nothing to show that these services provided by the assessee actually made available to the End User/ Channel Partners any technical knowledge, experience, skill, know-how or processes so as to enable them to

apply the said technology. Under these circumstances, we uphold the arguments of the learned Counsel of the assessee and allow the ground.

57. Coming to the submission of the Revenue that if the payments are not in the nature of FIS, then provisions of service PE applies and the entire transaction has to be considered as business income, we would deal the same in the ground relating to determination of PE.

Ground No 5

58. This ground deals with holding whether ACC constitutes the fixed place, Installation and Dependent Agent PE in India of Aspect US under the Tax Treaty.

59. The AO has held that the assessee has a fixed place PE, dependent agent PE and installation PE under the provisions of DTAA for the following reasons:

(a) The employees of Aspect US have been visiting India and have unhindered access to the premises of ACC

(b) Premises of ACC are at the disposal of the assessee and it is the place from where the assessee carries out its business

(c) In the transfer pricing analysis of the ACC only limited and preliminary functions are identified and the analysis revolves around low grade support only. The AO brought out a brief comparison of the functions as per the transfer pricing analysis and service contracts at page 46 to 51 of his order, to prove his point that the functions have not been properly identified by the assessee in the transfer pricing analysis. He concluded that the assessee has identified complete functions. Hence for the reasons given in the order, the transfer pricing analysis of Aspect, India is held to be defective. Hence he rejected the same. He held that ACC is a projection in India and Aspect, USA and ACC provides the important peoples function to the assessee.

(d) The subsidiary has been putting a logo/mark of the assessee and has not created any separate identity for itself

(e) ACC is economically dependent on Aspect, US and it qualifies to be a distributor of Aspect, US.

(f) ACC has de facto authority to conclude contracts on behalf of the assessee;

(g) ACC has habitually solicited orders for Aspect, US.

60. The AO also concluded that the assessee has an installation PE in India, for the reason that on account of the sales through channel partners, ACC is permanent installation and implementation office in India for the assessee. The DRP rejected the objections of the assessee in this regard and confirmed the finding of the AO.

61. The learned Counsel for assessee presented the following facts:

(a) Aspect US does not have any fixed place at its disposal in India. The premises of ACC is solely for the personnel of ACC and is not available to Aspect US at its disposal. The personnel of Aspect US have visited the office of ACC to occasionally use certain facilities however, the premises of ACC cannot be said to be available for Aspect US as per its convenience.

(b) The employees of Aspect US have visited India only for short trips for a total duration of 109 days. The purpose of the visits was to conduct business overview to understand the requirement of the existing customers, analysis of Indian markets etc. The travel log of the employee visits on sample basis and travel days of the employees to India was filed before us.

(c) The assessee has not carried on any business operations in India. All the contracts for supply of soft ware, hard ware and services are concluded outside India. The terms of contract are negotiated and concluded by Aspect US through an i- approach system loaded on the server located outside India. Further, the property in the products supplied by the assessee to the Indian customers is passed/ transferred outside India.

(d) In terms of service agreement entered into between Aspect US and ACC, ACC has a very limited market role which includes the following activities:

- To provide information on a continuous basis regarding the products and services to the potential customer.
- To define adequate promotion and marketing strategies
- To provide support services to customers.

62. Thus, the learned Counsel submitted that, the assessee does not have a place of business in India at its disposal and a place where "it has a right to use with a degree of permanence." The assessee does not exercise any degree of factual or operational control over the facility/premises and hence it does not have any place of business in India and that it did not carry out any business operations in India.

63. It was argued that, the assessee concluded all the contracts on supply of software outside India the contracts are initiated and concluded by Aspect, US through "i-approve" system, loaded on a server located outside India.

64. The property in the goods supplied to the Indian customers passes outside India and from this it is evident that Aspect, US did not undertake any business activity in India. The assessee has no employee in India for supply and other services in relation to hardware and software.

65. The employees visited India at irregular intervals for a total duration of 109 days to meet prospective clients, understand the requirement of existing customers, analyse the Indian market etc. which activity does not result in constitution of any P/E.

66. Even if the subsidiary company i.e. ACC carries out activities of the assessee, these are only auxiliary activities which do not constitute the core business activity of the assessee company. Hence, the case would also be covered under the specific exclusion provided under Article 5(4) of the DTAA. Hence it was argued that the assessee does not have a fixed P/E. Reliance was placed on the following case laws.

- Motorola Inc. vs. DCIT (SB) (2005) 95 ITD 269 (Delhi S.B.)
- CIT vs. Visakhapatnam Port Trust 144 ITR 146
- CIT vs. Morgan Stanley & Co.Inc.

67. On the findings of the AO that the assessee has an installation P/E it was argued that (a) the implementation services primarily involves uploading of software providing specifications to customers for environmental conditions/ systems (server) specifications etc. required for system set-up etc.
(b)It was submitted that the nature of implementation services in this case primarily involves implementation of software which is an intangible property, as distinguished from installation of tangible property/equipment as envisaged under various commentaries to constitute installation P/E.

68. Under the Treaties, the term 'installation project' is used for projects which requires substantial effort in terms of time, money, technical enterprise planning subsidiary and hence the nature of services of the assessee cannot be called installation services as contemplated in the Treaties. The

implementation services rendered by the assessee do not involve time/effort/physical activity.

69. On the finding that the assessee has a dependent agent PE, it was argued that:

(a) ACC, the Subsidiary company of the assessee is not categorically dependent on the assessee. This contention is borne out from the record where the facts are as follows:

   (i) In the agreements there is "a limitation of authority" clause which specifically restricts ACC to have an authority to conclude sales contracts in the name and on behalf of the assessee. The Subsidiary can not bind the assessee to the customers in India.

   (ii) The relationship between the assessee and its subsidiary ACC is that of an independent contractor, which is specifically provided in the service agreement between them.

70. The assessee and its subsidiary shall not control the day-to-day activities of the other party and allow either of the parties to create any obligation on behalf of each other. ACC is not legally or economically dependent on the assessee and is independent both economically and legally. Reliance was placed on the decision of the Mumbai Bench of the Tribunal in Variant India P.Ltd. vs. ADIT in ITA 4672 and 4676/Mum/2011 and she argued that the assessee:

(a) Has not habitually exercised to conclude contracts on behalf of the foreign enterprise, and

(b) Habitually secures orders in India for the assessee as a subsidiary has no such authority.

71. It was argued that ACC merely acts as a communication channel between the assessee and its ultimate customer. The function of ACC is described as follows: "to demonstrate the utility of the projects of the assessee to the customers as per their requirements and to pass on pricing function and contract terms as determined by Aspect, US."

The process was explained as follows:

- The end customer places the request with the channel partner, who after understanding the needs of the customers, submits the request to the ACC.
- ACC inputs the requests specifications to Aspect US via "I Approve" system which is controlled/managed by Aspect US.
- Basis the specifications, Aspect US informs ACC about the acceptance/ rejection of the request on the "I Approve" system.
- The same is communicated by ACC to the Channel Partners who in turn, communicate the same to the end users.

The following activities are done directly between Aspect US and the Customers:

- The Channel Partners/Customers raise the purchase orders on Aspect US;
- Orders are placed by the Channel Partners/Customers;
- Shipment of the product is directly made by Aspect US to the customers;
- Aspect US raises the invoice directly on customers/Channel Partners;
- Payment is remitted by the customer to Aspect US.

Hence it is submitted that the assessee does not have a P/E in India in terms of the Act.

72. The Ld.CIT, D.R. on the other hand listed out the revenues received by the assessee from Indian customers in this year as follows:

a)	Sale of software	$ 6585468 (48.10%)
b)	Sale of hardware	$ 3524795 (25.74%)
c)	Implementation services	$ 0491175 (3.58%)
d)	Maintenance services	$ 2879639 (21.03%)
e)	Professional services	$ 207083 (1.51%)

73. The Ld. D.R. further contended that no revenues were shown for training services though such training has been provided. He pointed out that 50% of the revenues are on account of licensing of software.

74. He referred to the assessment order in installation/implementation services as well as maintenance services and pointed out that the maintenance services are provided for a period of one year as a part of the licensing of software and sale of hardware and this can be renewed each year thereafter. The services listed out by the Ld.DR are:

a) Resolving bugs
b) New release of software
c) On line Pass Word protection, reporting, tracking tools and self help environment.
d) On site support as per applicable policies and procedures.
e) Telephone support to trained personnel.

75. The Ld.D.R. also pointed out that, for availing services it is necessary that the customers maintain current back up copies of all software, ancillary programmes and customary data and not to relocate any covered product from its original or subsequent location site.

76. The Ld.D.R. alleged that hardware sale and licensing of software is made through Indian subsidiaries and that all the services including

maintenance, professional, warranty etc. are also performed by Aspect India which is remunerated on a cost Plus market basis.

77. He submitted that in respect of services performed by Aspect India, the assessee is invoicing the customers and receiving all the payments.

78. The sum and substance of Ld.DR's submission is that the sale of equipment and performance of services and licensing of software are done to the customers by the channel partners or Aspect India only, but the revenues are accounted for by the assessee. He referred to the service agreement between ACC and the assessee dt. 9.2.2004, for providing sales support services and laid emphasis on Article 1 on page 56 of the first paper book as well as page 70 which is Exhibit B of the agreement. He also referred to various clauses of the Service agreement to demonstrate his point of view.

79. The Ld.D.R. alleged that the agreement in question is not signed and the assessee had not furnished the documents regarding change of name in parties and hence the agreement cannot be relied upon. These arguments are made by the Ld.DR with a view to demonstrate that the actual functions performed by Aspect India is in excess of the limitations placed on it by agreement dt. 9.2.2004.

80. He referred to the last service agreement between the Aspect Inc. and Aspect India effective from 1st August,2004 and submitted that under this agreement the contractor will perform research development, testing services, as it is requested by Concerto Software Inc. i.e. the assessee company Aspect Software Inc. He also referred to the amended agreement dt. 20th December,2006 and alleged that the assessee has not submitted any

information on the services provided by the contractor and it is not clear whether this agreement concerned a separate business of the assessee and for which no income has been offered to tax.

81. Ld.D.R. gave the departmental version as to how from the revenue's point of view, the sales are made and the licensing of software was done. For this purpose he relied on the assessment order and argued that the information on the activities and role of Aspect India, with respect to the business of the assessee in India was not forthcoming and hence the AO issued notice u/s 133(6) of the Act.

82. Thereafter the Ld.D.R. submits that Aspect India the Indian Subsidiary or the channel partners identified the customers, under the specifications or requirements and for this purpose, it involves meetings, presentations etc. to suit the customer requirement. He alleged that Aspect India prepares a comprehensive proposal including prices and sends to customer, channel partner who in turn submits its quote and a purchase order from the customer to the sale team of Aspect India.

83. The Ld.DR submits that based on these proposals by the subsidiary, the channel partner submits its report and purchase order from its customer to the sales team of Aspect India. Aspect India enters the requisite specification on the "I Approve" system, which is a platform where in all the information about the sale is entered into by the subsidiary, including customer I.D., price, discounts, requesting persons etc. reasons justifying the price, request price, discount etc. He contended that the information is completed by the sales team of Aspect India and it was subsequently assigned to various persons for approval including country Manager of Aspect India. Justification for the price/discount offered by Aspect India while negotiating terms and conditions

are mentioned in the “I approve”. The activities undertaken and decision taken by Aspect India in making sales gets fully documented in “I Approve”.

84. In view of the above, the Ld.D.R contends that the documentation in “I Approve” system explicitly demonstrate that all the functions in regard to sale/licensing, including the decision regarding prices are negotiated and decided by Aspect India and that there is no role of Aspect U.S. in negotiating prices and response from customers.

85. He listed out the functions, which as per the Ld.DR, are carried out by Aspect India and argued that these functions demonstrate a totally different picture than what has been stated in the agreements between the two related entities. Thus he submits that the functions performed are not properly disclosed in the T.P. analysis and that these agreements have not correctly captured the services provided by Aspect India and are to be considered as self-serving documents.

86. He pointed out that the proposals are also prepared to get approvals for non standard payment terms. The sales team of Aspect India also secured orders for customers in Sri Lanka and Saudi Arabia and this was not disclosed in the T.P.study.

87. The sum and substance of the contentions is that, Aspect India performs the core functions of customer profiling, price negotiation and closure of the deal and its function is not limited market support as claimed by the assessee. He contends that the burden is on the assessee to lead evidence otherwise and that this is not discharged.

88. He contended that there is no case where Aspect Inc. has refused any "I Approve" submitted by Aspect India and argued that this shows that the prices and discounts initiated by the Indian Subsidiary are final and that the assessee has no direct role. The Ld.D.R. stated as follows:

- *The claim that the customer is free to purchase any individual product or services, as many customers have purchased only the services during the year without acquiring any hardware or software. Some customers purchased license for the software from the assessee without purchase of the equipment {page 186, PB-2}. This claim of the assessee is factually correct and substantiates the Revenue position that software is not embedded in the hardware and can be licensed independent of purchase of hardware.*
- *The claim that channel partners are independent could have been proved by submitting information that they purchase products on their account for a price and in turn sell to the customer for a price decided by them. From the facts discussed above, the channel partners make purchases for the customers and the prices are negotiated by Aspect India. Purchase orders are placed by the customers that are secured by Aspect India. Assessee has not submitted information on sale of equipments and licensing of software that are done directly by Aspect India to customers and those done through channel partners.*
- *Claim that Aspect India acts as a communication channel between the assessee and the customers is factually incorrect, as to act as a communication channel, Aspect India should have acted as a post office only without adding any value to the communication. As discussed above, Aspect India is performing all activities relating to sale/licensing of products in India including negotiating and approving the prices. There are no direct role/efforts made by Aspect Inc in India except the presence of its employees during the year for overseeing its business in India. Aspect India is the projection of Aspect Inc in India and Aspect India is authorised to act as such before Indian customers. Designations of employees are evidence of this position.*
- *Assessee claim that it identifies customers in India and maintains the relationship is false and baseless and totally contrary to the facts brought out on record. It must have demonstrated that Aspect Inc. (and nor aspect India) identifies customers and make sales. What is the set up of the assessee in India other than Aspect India? And what are the expenses in this regard? The assessee as a responsible corporate citizen should desist from making unsubstantiated claims.*

- *Claim that majority of sales in India are made to channel partners where Aspect India has no role to play. In this regard, as demonstrated above, no sales/licensing in India is made without the involvement of Aspect India. In no case, the customers or channel partners had any direct dealing or interaction with the assessee outside India and this is out of question when Aspect India has employed persons who have designations as channel managers, sales manager, and senior sales manager and director sales.*
- *Claim that channel partners do not require any concurrence from the Appellant for sale of the product to the ultimate customer is apparently not correct because the channel partners do forward the purchase order of the end customer to Aspect India and the discounts are decided by the Aspect India.*
- *Claim that Aspect India acts as a communication channel between the assessee and the customers in Sri Lanka and Middle East and, per se, does not sell on behalf of the assessee or secure orders for the assessee. This claim is contrary to facts as evident from the statement of Director Sales of Aspect India. Can assessee explain that when the Aspect India is not making sales, as per its claim, then why the employees of Aspect India have designation of Director sales/manager sales Asia, Sri Lanka and Middle East? It is the assessee who is present in India through Aspect India and carries business in India, Sri Lanka and Middle East. The assessee could have submitted the travel expenses detail of Aspect India to demonstrate that employees of Aspect India did not visit these countries.*
- *Claim that customer directly contact with the assessee is factually incorrect as no customer has ever directly interacted or corresponded with the assessee. Similarly the assessee has never come in contact with the customer.*
- *It has been claimed that majority of sales are made to channel partners. Information on all the channel partners, date of agreement and sales made through them is not submitted, therefore, this claim is in vacuum.*
- *The claim that Aspect India provides support to the assessee in rendering services is also contrary to facts as all services are provided by Aspect India. Assessee may have rendered services directly to Indian customers while employees of assessee were present in India. Aspect India provides support to the assessee but majority of these services are provided by Aspect India to customers.*

- *Claim that assessee does not play any role in performance evaluation of employees of Aspect India could have been substantiated by submission of performance evaluation report of employees, say Shri Shankar Balu to indicate that his incentives/ promotions/salary is not dependent on sales targets achieved by him.*

- *Assessee has claimed (page 191 of PB-2) that it had submitted copy of "I-Approve" where the proposals of discounts made by Aspect India have been rejected. The Revenue could not find any such document in the Paper Books filed by the assessee. AO has adversely commented on this issue therefore such documents were also not filed before the AO.*

89. Based on the above understanding of the facts the Ld.D.R. contended that the following claims of the assessee are factually incorrect:

a) That the transactions between the assessee and its customers are on principal to principal basis
b) Supply of hardware and software is made outside India
c) Payment of the goods are received outside India
d) Property in goods is transferred outside India and
e) All the contracts for supply of hardware and software are concluded and signed outside India.

90. The Ld.D.R. relied on the order of the AO and contended that:

* the assessee did not prove its claim that the contracts are concluded outside India;

*channel partners prepared quotations based on information provided by Aspect India;

* even if the server is located outside India, it is not of any significance because the business of Aspect India is done through same server;

* all employees of Aspect India has e-mail address of Aspect.Com and have direct access to "I Approve" and hence the computer system of Aspect India is just an extension of the system of Aspect USA which the subsidiary uses without any cost to it;

* the prices are negotiated and approved by employees of Aspect India and all important decisions are taken in India;

* the claim of the assessee that the employees of Aspect US visited India for the limited purpose of meeting prospective/existing customers etc. supports the revenue's decision that all sales related activities are carried out by the subsidiary only;
* the support provided by the assessee's employees to the subsidiary cannot be considered as a preparatory and ancillary activity. As the core business of sale equipment, licensing of software and provide services;
* the designations given to the employees of the subsidiary indicate that it is these employees who actually perform the sales functions;
* the assessee's product is being sold in India as Aspect India and this business is supervised by the assessee's employees during the visits

Addressing the issue of existence of a Fixed Place P.E., the Ld. CIT, D.R. submitted that:-

- The employees of the assessee stayed in India during the F.Y. for the duration of 157 days;
- Some of them stayed for very long periods, e.g. the Manager Technical Support stayed for 29 days;
- Aspect India provide office premises/sets the employees of the assessee company;
- transfer pricing analysis of the assessee for FY 2002-03 and 2003-04 referred to tangibles owned by it and that the Indian subsidiary has used an ITC system of the assessee for the business in India and this international transaction is not recognized in the report that the assessee's assets are used by the Subsidiary in India free of cost;
- In TPO's order the fact of earning commission of hardware sale is not identified as international transaction;
- Thus as the Ld.DR contends that as the business of the assessee is carried out through the premises of Aspect India and through employees

of Aspect India it is established that the assessee has a fixed place P.E. in India.

91. We have considered the rival contentions and the material on record. The existence of PE in India is the matter of dispute in this ground. Revenue has contended that the assessee has fixed PE, installation PE and Dependent Agent PE in India. Our finding in respect of each of the forms of PE is as under:

<u>Fixed PE</u>: As per Article 5(1) of the India –USA DTAA, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. Article 5(2) deals with various instances resulting in PE. Article 5(3) deals with cases or facts which do not result in PE. One of the exceptions under Article 5(3) is maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise. The assessee has contended that its activities in India are of preparatory or auxiliary character and, hence, there is no PE in India. The revenue, on the other hand, has contended that the business of the assessee is already set up in India and, hence, there cannot be any 'preparatory' and the sale activity undertaken is the main business activity and cannot be regarded as 'auxiliary' nature. As regards the fixed place of business in India, it is contended by the assessee that the business place of Aspect India is not under the control or at the disposal of the assessee and, hence, there is no fixed PE. The revenue, on the other hand, has contended that since the employees of the assessee were in India, the assessee has carried on business in India. After considering the material on records, we are of the view that neither the assessee nor the revenue has been able to conclusively demonstrate the absence or presence of the assessee's fixed place of business in India under Article 5 of the India –

USA Treaty. The revenue has, further, contended that the assessee has not submitted the information on visit reports submitted by the employees and information on e- mails of these visiting employees. We, therefore, set aside the matter and remitted to the assessing officer for proper verification regarding existing of PE in India. The assessee also shall submit the details as called for by the assessing officer.

<u>Installation PE:</u> The revenue contends that since installation and support services are provided by Aspect India, there exists an installation PE of the assessee in India. As per Article 5(2) of India – USA Treaty, the term 'Permanent Establishment' includes especially the following:

(i) Clause (j): An installation or structure used for the exploration or exploitation of natural resources, but, only if so used for a period of more than 120 days in any twelve-month period;

(ii) Clause (k): A building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve-month period.

There is no dispute that clause (j) above is not applicable. The dispute is with regard to existence of PE under clause (k) above. As per Article 5(2)(k), a building site or construction, installation or assembly project or supervisory activities in connection therewith is regarded as PE is such project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve-month period. Article 5(2)(k) should be read as a whole. The term 'in connection therewith' would apply for the entire preceding words viz., a 'building site or construction, installation or assembly project or supervisory activities'. The term installation project cannot be read de-hors the words accompanying it. Thus, when the entire clause is red as a whole, it would be evident that the installation or assembly project or supervisory activities should be in connection with the building site or construction. In the present case, there is no dispute that the assessee does not carry on business in India through a building site or construction. Consequently, we are of the view that there is no installation PE of the assessee in India.

Dependent Agent PE: Article 5(4) of India – USA Treaty deals with the Dependent Agent PE. It reads as under:

Notwithstanding the provisions of paragraphs 1 and 2 where a person-other than an agent of an independent status to whom paragraph 5 applies –is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if:

(a)	He has and habitually exercises in the first-mentioned State an authority to conclude on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;
(b)	He has no such authority but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in the State on behalf of the enterprise have contributed to the sale of the goods or merchandise; or
(c)	He habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise

The first and foremost requirement under Article 5(4) is that the said Article will apply to a person other than an agent of an independent status to whom paragraph 5 applies. Paragraph 5 of Article states as under:

> "5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph."

Paragraph 5 lays down conditions as to when can an agent; broker is regarded as dependent agent or independent agent. If the agent is devoted wholly or almost wholly on behalf of the enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, the agent is not considered as agent of 'independent status'. In such circumstances, the agent would be regarded as 'dependent agent'. Further, the dependent agent has to satisfy any of the tests laid down in (a), (b) or (c) above in order to constitute a dependent agent PE of the non-resident. Coming to the facts of the present case, the assessee has argued that Aspect India neither secures orders nor habitually exercises an authority to conclude on behalf of the assessee. It is, therefore, contended that there is no dependent agent PE in India. The revenue, on the other hand, has argued that the assessee has not submitted proper facts to substantiate its contention. It is submitted that the assessee has not submitted information on sale of equipment and licensing of software that are done directly by Aspect India to customers and those done through channel partners. It is contended that the assessee has not demonstrated that it identifies customers and make sales. The statement recorded from the Director, sales of Aspect India is stated to be contrary to the claim of the assessee that Aspect India only acts as a communication channel between the assessee and the customers. Similarly, the assessee's claim that majority of sales are made to channel partners is stated to be factually incorrect since information on all the channel partners, date of agreement and sales made through them is not submitted. It is argued that copy of 'I Approve' system has not been submitted by the assessee for factual verification. Considering these facts, we are of the view that both the revenue and the assessee have not been able to demonstrate the existence or otherwise of the 'dependent agent PE'. In the absence of proper information in this regard, we are unable to decide whether the assessee has a 'dependent agent PE' in India. We accordingly, set aside the issue of 'dependent agent PE' and restore to the assessing officer for fresh consideration.

Ground 6 , 6.1

92. This ground is on revenue earned from supply of software and rendering of maintenance and professional services to customers located in Sri Lanka and Middle East as "Royalty/ FTS/ FIS" under the Act and the Tax Treaty.

93. The Assessee has provided sales and support services to customers in Sri Lanka and Middle East. The factual aspect of providing services in respect of sales to customers in Sri Lanka and Middle East came to light during the statement recorded of Shri Balu , Sales Director (South Asia and Middle East) under section 131 of the Act.

94. The AO taxed the revenue earned by assessee from supply of software and provision of support services from customers based in Sri Lanka and Middle-East Asia under Sec. 9(1)(vi) and (vii) of the Act and under Article 12 of the Tax Treaty. Further, the AO also attributed 15% of the revenue earned from supply of software and hardware and 57.5% of the revenue from provision of support services from the said customers to the alleged PE in India. The DRP has confirmed the addition.

95. The learned Counsel for the assessee submitted that the revenues from supply of software and rendering of services are from the customers located in Sri Lanka and Middle East is not taxable in lieu of her submissions made while arguing ground nos. 2 to 4 in this appeal.

96. Alternatively and without prejudice to the above submissions, she submitted that the revenues were earned outside India and the services were also rendered outside India i.e. Srilanka and Middle East. Hence, the same is not taxable in India. She drew our attention to the provisions of Sec.5 of the Act and Article 12 of the Tax Treaty and submitted that as per Sec.5 of the Act, the 'total income' of a non-resident tax payer would be the income which has been received in India or has accrued or arisen or deemed to accrue or arise in India. Sec.9 of the Act which deals with Income deemed to be accrued or arise in India provides that any income by way of royalty or FTS shall be deemed to accrue or arise in the hands of a non-resident only if:

- The royalty and/ or FTS is payable by a **<u>resident,</u>** **<u>except</u>** where royalty is payable in respect of right, property or information used or services utilized for the proposes of a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India or for the purpose of making or earning any income from any source outside India.

- The royalty and/ or FTS is payable by a **non-resident** only if royalty is payable in respect of any right, property or information used or services utilized for the purpose of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India ....”

97. The Ld.Counsel for the assessee submitted that in the instant case, by no stretch of imagination it can be construed that the consideration paid by the end users/channel partners based in Sri Lanka and Middle East to the assessee for purchase of software and provision of services has been utilized for their business carried on in India or for the purpose of making or earning of any income from any source in India. Thus, no income can be brought within the ambit of India taxation.

98. Further, she drew our attention to Article 12 of the Tax Treaty which read as under

“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 fee for included services may also be taxed in the contracting state in which they arise and according to the law of that state.........

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.

99. She submitted that in view of the provisions Article 12 of India-USA tax treaty, royalties/ FIS paid to a resident of US may be taxable in India only if the same is arising in India. Article 7(a) of the India-USA tax treaty provides that the Royalties and FIS shall be deemed to arise in India only where the payer is resident of India or has a PE or fixed place in India and such royalties/ FIS are borne by such PE or fixed place.

100. In the instant case, even if the consideration from sale of software and services is construed to be in the nature of "royalties and FIS ", the consideration received for the sale of software and services from the payer based in Middle East and Sri Lanka cannot be taxed in India as the same has not arisen/ deemed to arise in India. The provisions of the India-USA tax treaty clarifies that once it is construed that the US enterprise has a PE in India, royalty and fees for included services shall be taxable as per the provisions of Article 7 of the India-USA tax treaty. Thus, the income from sale of software and services from Middle East and Sri Lanka has incorrectly been taxed in India.

101. The learned CIT-DR submitted that the assessee had always hidden the transaction from the tax authorities and these transactions were discovered from the employees of Aspect India during the statement recorded under

Sec131 of the Act. It is unfortunate that the assessee is blaming the revenue that there is no material on prove that the services are rendered in India. Be that as it may, there is no dispute about provision of services by Aspect India, The services are provided are very high end and due to such services Aspect US is earning revenue from these countries without being physically present there. The income to assessee from customers in Sri Lanka and Middle East do arise due to operations/ activities of Aspect India from within and outside India has full nexus with India. Accordingly, income is taxable in India.

102. In her rejoinder to Revenue's allegation that the assessee had hidden the transactions from the tax authorities and the fact of the transaction came to the notice of the AO while recording the statement of Mr. Shankar Balu, the learned Counsel for assessee submitted that the since the revenue received from the customers located outside India for supply of software could not have been brought within the Indian taxation, there was no requirement on the part of the assessee to disclose such income in the tax return. By no stretch of imagination, the assessee could have though that the Learned AO will link the receipts with Indian operations of the Aspect US. Further, the AO also did not specifically ask for the details. However, subsequently when the AO requested for details, the assessee had fully co-operated with the Revenue. In absence of any specific details, it will be unjust to penalize the Appellant for a transaction having no nexus with India.

103. We have heard the rival contentions and perused the record. We find it difficult to accept the arguments of the learned CIT-DR for taxing the said receipts. In view of our observations in Ground No 2, 3 and 4, we hold that the revenues earned from customers located in Sri Lanka/ Middle East are not taxable under the Tax Treaty. Even otherwise, we are of the opinion that the said revenue is not taxable under Sec. 9 of the Act. We state our reasons below:

104. In the present case the revenue is received by the assessee from customers located outside India (i.e. Sri Lanka/ Middle East). Therefore, the taxability of the transaction is governed by provisions of Sec. 9(1)(vi)(c)/ 9(1)(vii)(c) of the Act. Thus, to tax the royalty/ FTS income earned from such customers in the hands of Aspect US, the transaction should fall within the provisions of Sec 9(1)(vi)(c)/9(1)(vii)(c) of the Act.

105. Sec. 9(l)(vi)(c)/ 9(1)(vii)(c) of the Act are deeming provisions and have to be construed strictly. A plain reading of both the sections shows that any income earned by a non-resident tax payer (**i.e. Aspect in the present case**) by way of royalty / FTS is taxable in India, if such royalty/FTS is payable by a non-resident (i.e. **customers located in Sri Lanka/ Middle East**) in respect of any right, property or information used or services utilized:

(a) for the purposes of business, or profession carried on by such person (i.e. customers located in Sri Lanka/ Middle East) in India; or

(b) for the purpose of making or earning any income from any source in India.

Thus to tax the income earned by Aspect US from customers located outside India under Sec. 9(l)(vi)(c)/ 9(1)(vii)(c) of the Act, the Revenue must prove that the customers located in Sri Lanka / Middle East carry on business in India and that they have used Aspects US rights in the IPs/ services for the purposes of such business in India; or that they have used rights in the IPs/ Services for the purpose of making or earning income from a source in India. In the present case, the Revenue taxed the said income on the sole reason that these services are provided by Indian subsidiary of the asseseee and the asssessee is earning huge income from these customers. The AO has not brought anything on record to show that the customers located in Sri Lanka/ Middle East have used the rights in the IPs/ services for carrying on business in India or for the purpose of making or earning income from any source in India. Under these circumstances, we agree with the arguments of the learned counsel for the assessee that the revenue in question cannot be brought to tax under the Act.

106. As we have held that the revenue in question cannot be brought to tax as “royalties/FTS” under the Act under the provisions of the Income Tax Act, 1961 itself, we do not find it necessary to examine the taxability of the same under Article 12 of the Tax Treaty.

Ground no 7 and 8

107. These grounds are against double taxation of income and application incorrect rate of tax for computing the tax on royalty/ FTS income on gross basis.

108. The learned Counsel for the asseessee has submitted that the AO has taxed the revenue from supply of software earned and rendering of implementation, maintenance and professional services to customers located in India, Sri Lanka and Middle East as “Royalty”/“FTS” on gross basis @15% and also proceeded to attribute certain percentage of the revenue to the alleged PE thereby, resulting in double taxation of income. Accordingly, she prayed for relief. Further, she submitted that the learned AO has used the incorrect rate of tax while computing the tax on gross basis. The Ld. AO has taxed such income @ 15% irrespective of whether the agreement has been entered into on or before June 1, 2005 or thereafter. Hence, even where the agreement is entered after June 1, 2005, the AO has taxed the income @ 15% instead of 10% (plus applicable surcharge and cess) under section 115A of the Act.

109. The learned CIT-DR submitted that assessee's claim to be taxed at the tax rate of 10% in view of the provisions of Section 115A of the Act could have been correct, had it opted to be taxed under the provisions of the Act and not under the Tax Treaty. The assessee cannot do shopping of the royalty provisions under the Tax Treaty for the purpose of scope of royalty and then turn to the Act for the purpose of tax rate. Since the asseessee has made a choice of taxation under the provisions of Tax Treaty and it needs to stick to it. Tax rate is provided in paragraph 2 of Article 12 of the DTAA. Accordingly, this ground of appeal is required to be rejected. He placed relied on the decision of the Delhi ITAT in the case of Pizza Hut International (22 Taxmann.com 111, Delhi ITAT) where in the co-ordinate Bench of this tribunal has held that the assessee is not eligible to choose the tax rate under the Tax Treaty and then claim the exemption from gross up of tax under the Act, in that case tax rate under the Act would apply.

110. We have heard both the parties. In view of the decision given in ground No.2, 3, 4 and 6 on taxability of revenue earned from supply of software and support services from customers located in India, Sri Lanka and Middle East, ground No.7 and 8 has become purely academic. Therefore no adjudication is required.

Ground No 9

111. By way of this ground, the assessee, without prejudice to its arguments that it does not have a P.E. in India, contends the method of attribution of profits is not in accordance with the law.

112. The AO having held that the assessee has a fixed place, installation and Dependent Agent PE in India in the form of ACT attributed the following sums to the PE :

- 15% of the revenue earned from software licensing and hardware sales from customers in India and outside India (i.e. Sri Lanka and Middle East).
- 57.5 % of the revenues earned from rendering of services to the customers in India and outside India (i.e. Sri Lanka and Middle East).

The DRP upheld the attribution done by the AO.

113. The learned Counsel for the assessee submitted that in the instant case no profits are attributable to the alleged P.E. of the assessee on account of the following:

(a) The provisions of the Act and judicial precedents, lay down the basic principle for attribution of profits of a non-resident operating through a business connection in India, that where a business connection of a non-resident is constituted under the Act, the total income of such a non-resident would be subject to tax in India, but only so much of the income of such non-resident as is reasonably attributable to the operations carried out in India would be subject to tax in India. Reliance was placed on the Hon'ble Supreme Court decision in the case of Ishikawajima Harima Heavy Industries Ltd vs. DIT (288 ITR 408, SC).

(b) In the context of onshore activities incidental to the sale of goods, it has been held that where the sale of goods has taken place outside India and the activities carried out in India are only incidental/ ancillary to such sale, no profit/ loss can be attributed. Reliance was placed on the decisions of the Hon'ble Andhra Pradesh High Court in the case of CIT vs. Navbharat Ferro Alloys Ltd (224 ITR 0261); CIT vs Hindustan Shipyard Ltd (109 ITR 0158) and CIT vs Sundwiger Empg and Co (261 ITR 110).

(c) Further, the Central Board of Direct Taxes ('CBDT') in its circular No. 23 dated July 23, 1969, with a view to clarify the position, stated that in respect of sales made by a non-resident to Indian customers either directly or through agents, the income of the non-resident arising in India would be limited to the amount of profit attributable to the services of the agent. Even though the circular has been withdrawn by the CBDT presumably to prevent its un-intended misinterpretation, the principle as held by the Supreme Court (as discussed above) in various decisions still holds good and what can be attributed to a business connection can only be with reference to the activities performed in India. Hence, without prejudice to the contention that Aspect US does not constitute a PE in India, it is submitted that even where Aspect US is held to be taxable in India on the grounds of it having a PE as per Article 5 of the tax treaty, what can be taxed in India are only those profits that have been earned from operations carried out in India.

(d) The Act does not prescribe any specific methodology for attribution of income. Rule 10 of the Income-tax rules, 1962 ('the Rules') relevant to Section *9(1*)(i) of the act *inter alia* specifies that where the actual amount of income accruing or arising to any nonresident, whether directly or indirectly, through or from any business connection in India; or through or from any asset/source of income in India, is according to the tax officer not definitely ascertainable,_then the tax officer may calculate the amount of income, accruing or arising in India, in any of the following manner:

- A percentage of turnover so accruing or arising as the tax officer may consider as reasonable.
- An amount which bears the same proportion to the total profits and gains of the business, as the receipts so accruing or arising bear to the total receipt of the business.

- An amount calculated in the manner in which the tax officer may deem suitable.

However, where the amount attributable to the Indian operations is not definitely ascertainable, the apportionment of profits under the prescribed Rule 10 has to be on a rational basis. It has been judicially held that in adopting one of the three methods prescribed in Rule 10, the applicable method shall be the one for which the relevant information is available. Reliance was placed on decision of the Delhi ITAT in the case of Iraqi Airways (23 ITD 115, Delhi ITAT).

Further, the profit or loss so worked out would need to be attributed on the basis of operations actually carried out in India and profit or loss attributable to activities carried outside India would need to be excluded She relied on the decision of the Hon'ble Supreme Court in the case of Ahmedbhai Umarbhai & Co. (18 ITR 472, SC) and decision of Special Bench of ITAT in the case of Motorola Inc (95 ITD 269, Delhi ITAT SB).

(e) Even under Article 7 of the Tax Treaty, only such profits as are directly or indirectly attributable to the PE of Appellant in India shall be taxable in India.

(f) In determining the profits attributable to a PE, it is necessary to determine the allocation of Functions, Assets and Risks ('FAR') to the PE and the attribution of income to the PE under arm's length conditions. In support of her arguments, the Counsel relied on the decisions of the Hon'ble Supreme Court of India in the case of Morgan Stanley & Co. Inc. vs. DIT (292 ITR 416) and the Bombay High Court in the case of SET Satellite (Singapore) Pte Limited ('SET') (307 ITR 205, Bom HC) wherein the Hon'ble Courts have held that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE.

(g) In view of the provisions of the section 7(2) of the Tax Treaty and the judicial precedents, it can be inferred that as long as the PE is being remunerated at arms' length price, nothing further may be attributed to the operations/activities carried on by the PE of the foreign enterprise in India.

Applying the above principles to the facts of the present case, it was submitted that no profits are attributable to the alleged PE of the Appellant in India, on account of following:

- Aspect US has not carried on any business operations in India;
- All the contracts for supply of hardware, software and services are concluded by Aspect US, outside India;
- The property in the products supplied to the Indian customers also passes on outside India;
- The terms of the contract are negotiated and concluded by Aspect US through 'i-approve' system, loaded on the server that is located outside India;
- The onsite implementation services provided by the Aspect US through Aspect India are incidental to the contract for supply of hardware and software and thus, would partake the character of sale of hardware and software itself.
- No further business profits can be attributed to the alleged PE as Aspect India has been remunerated at arm's length price by Aspect US for the services provided.

(h) It was further submitted that the AO without giving any reason, rejected the cost plus mechanism to compute the remuneration payable to Aspect India for the services rendered by it to the assessee. The AO held that computation of remuneration based on actual fees charged by the assessee from the customers, is a better method and adopted the same mechanism for attributing profits to the alleged PE. As long as remunerated paid to Aspect India is at arms' length price and in consonance with provisions of the Act, the AO has no jurisdiction to question the method of computation of remuneration.

(i) Aspect India is a private company registered under Companies Act, 1956 and is being assessed to income tax in Circle 3(1), New Delhi and the said transfer pricing analysis has been subject to assessment by Transfer Pricing Officer- 1(4) New Delhi ('the learned TPO'). The learned TPO for the Assessment Year 2003-04, 2004-05 and 2005-06, after due consideration of the services provided by Aspect India to Aspect US, has held that the Aspect India has been remunerated at arms' length price for the services provided to Aspect US. In the AY 2006-07, the learned TPO has however, made certain adjustments to the mark up received by Aspect India for services provided to Aspect US. However, Aspect India has not accepted the aforesaid adjustments and appealed before the Hon'ble ITAT and the Hon'ble ITAT has remanded the matter to the file of the DRP.

(j) The scope of services rendered by Aspect India in the subject assessment year under consideration is similar to the services, provided by Aspect India in the prior years, which have duly been scrutinized by the learned TPO. The AC, while making the above allegations, has not taken cognizance of the order of the learned TPO and has acted beyond his jurisdiction.

In view of the above, it was submitted that Aspect US does not have any assets in India and since Aspect India has been remunerated at arms' length price for the services provided, no further profits can be attributable to the alleged PE of Aspect US in India.

114. Without prejudice to the contention that no further income can be attributed to the alleged PE, if any, of Appellant in India, it was submitted that even if income is sought to be attributed, the same should be done having regard to the net income derived by Appellant from Indian operations, further restricted to the amount which can be attributed to the functions carried out in India. It was submitted that the following are the various functions performed /risks associated with the hardware/software sales are affected by assessee:

- Research and Development in relation to the product
- Purchase/ procurement of raw material
- Manufacturing using plant and machinery in USA
- Sales and Marketing
- Ancillary services viz, installation service
- Support services viz, trouble shooting, updates, etc.
- Administrative and overall management function
- Credit risk

The functions performed in India are restricted to undertaking limited marketing function and providing ancillary services in the context of installation of software supplied. All the other functions/risks were exclusively carried out/undertaken in USA. In fact, the sales function involving conclusion of contracts and all decision making regarding pricing and terms were also undertaken in USA. The necessary support in form of directions and instructions in respect of installation and commissioning also happens in USA. The assessee neither assumes any risk of customers not does it holds any assets in India.

115. Alternatively and without prejudice to the above contention that no further income can be attributed to the alleged P.E., if any, of the assessee in India, it was argued that the attribution should be done having regard to the net income derived by the assessee from global operations and further restricted to the amount which can be attributed to the functions carried out in India. Listing out the various functions, she submitted that the functions performed in India are restricted to undertake the limited marketing function and provision of ancillary services (i.e. implementation services). She contended that the assessee neither resumed any risk of customers nor does it hold any assets in India. She relied on the mechanism provided under Rule 10(ii) and submitted that the AO has failed to consider the global annual accounts submitted with the office of the Ld.AO vide submission dt. March 12, 2009 to determined profits attributed to the alleged P.E. of Aspect U.S.Inc.in India. It was submitted that as the assessee has incurred losses globally for the FY 2006-07 no profit can be attributable to the P.E. for the subject Assessment Year.

116. One more alternate argument was raised without prejudice to the main contention and it was submitted that only profit can be taxed under the Act and treaty and that the AO wrongly identified 15% of the sales as attributable to the P.E. and tax the same. She suggested the following formula for computing the profits attributable to the P.E. in India :

Revenue (x) Attribution Rate (x) Profit rate

She argued that the AO should apply the profit rate instead of attributing a portion of the revenues as profits of the P.E. For the proposition that net profit rate should be applied to the revenues that are attributable to the P.E. for the purpose of arriving at the profits attributable to the P.E., the Learned Counsel relied on the following case laws.

- Nokia Corporation (95 ITD 296, Delhi SB): 20% attribution of weighted net profit. Functions identified were (a) Network planning (b) Negotiations in connection with the sale of equipment (c) The signing of the supply and installation contracts.
- Ericsson Radio Systems A.B. (Supra) — The HC has also made an observation that 20% attribution appears to be higher than what is warranted under these circumstances while remanding the matter back for fresh adjudication.
- Convergys (Supra) — The ITAT has attributed the 'Profits' and not simply restricted to attribution of 'Revenue'.
- Huawei Technologies (Supra) - 20% attribution of Profits has been held for similar allegations.
- Annamalais Timber Trust and Co. vs. (41 ITR 781, Mad HC) - Confirmed the Tribunal's decision that 10% of the income can be attributed to trading operations in India.
- CIT vs. Bertram Scott Ltd. (31 Taxman 444,Cal HC) — The HC held the same percentage as income attributable to the signing of the contracts in India in the case of.

117. The learned CIT-DR submitted that the profits on account of sale of hardware would be taxable to the extent attributable to the PE in India. The income from licensing of software and support services is taxable as royalty/ FTS. Up to FY 2003-04, Aspect India was rendering distribution, maintenance and support services to assist implementation of global contracts. Aspect India was receiving commission at 11% on the sales value of software and hardware distributed and was getting actual fee charged by Aspect US in respect of

consultancy and support services provided by Aspect India to the customers. During the FY 2004-05, the method of compensation of the Indian company was changed and now the assessee claims to have performed limited marketing activity in India.

118. He argued that while the business arrangement has changed in form, in substance nothing has changed. If the assessee's argument that the role of Aspect India became limited is to be accepted then the assessee has to explain who else is performing the remaining activities for the assessee in India. In the assessment proceedings of the Indian subsidiary, the assessee was totally non –cooperative and had not submitted the required information. The assessment order notes the inconsistent position taken by the assessee regarding its role with regard to sales and services.

119. With respect to taxability of hardware, he submitted that the agreement as well as the invoices uses the term equipment. The sale of equipment has been expressed as sale of hardware in the assessment order. Based on the direction of the DRP, income from hardware has been determined @15% of hardware sales. In the grounds of appeal filed before the Tribunal the assessee has not objected to the taxation of hardware sales and is only aggrieved by the rate of attribution @ 15% of the hardware sales made to customers in India.
As the assessee does not have any legal objection with regard to taxability of revenue earned from hardware sales, therefore the arguments that sales are made on FOB basis outside India can only be considered as an argument to object that attribution made at 15% of sales revenue. The assessee has not raised any ground that income from hardware sales is not taxable as per the provisions of section 5 and section 9 of the Act. Assessee has not challenged the finding of the AO that it has business connection in India. It has grievance against the finding of the AO regarding PE and attribution of income on

account of hardware sales. The learned counsel of the assessee has argued that in view of Supreme Court Ruling no income from hardware sales is taxable in India. However, neither the ruling was cited nor a copy of the same is filed in the Paper book, therefore the revenue is unable to respond to this claim. Without prejudice to this position, if the title to the equipments and risk of loss to the products passing to the Customer upon shipment which is FOB Aspect's shipping location (Clause 5(c) on page 86 of the PB, in that case income may not accrue or arise in India but income will still deem to accrue or arise in India on account of operations in relation to sales being carried out in India and business connection of the assessee and income in relation to such operations is taxable in India as per provisions of Section 5(2)(b) of the Act. In this regard, reliance was placed on the decision of the Hon'ble Apex Court in the case of Anglo French Textile Company Limited Vs CST (25 ITR 27).

120. Explanation 1 to clause (i) of Section 9(1)(i) provides for attribution of income based on operations carried out in India. Equipments are no doubt not manufactured in India but operations in regard to sales have been undertaken in India. Therefore, the income on account of these operations is taxable in India as per the provisions of section 5(2) of the Act.

121. On the assessee argument that in absence of a PE no profits on account of sale of hardware can be attributed to the alleged PE, it was submitted that the assessee has PE in India and the PE was involved in all the pre-sales activities including price negotiation of equipments. Therefore, the AO has rightly attributed profits as per provisions of Article 7 of the Tax Treaty. Prior to the new arrangement of cost plus, a commission of 11% of the sale price was being paid to Aspect India for the services provided by them in connection with such sales. Thus, considering this measure the AO has rightly attributed the profits to the PE.

122. In her rejoinder, the learned Counsel for the assessee submitted that the statement made by the Learned CIT-DR that the assessee has no objection with regard to the taxability of revenue earned from hardware sales is invalid. She submitted that assessee's primary argument is that the Appellant does not have a PE in India and in the absence thereof, no profit on account of sale of hardware can be attributed as taxable in India. However, without prejudice it is submitted that if PE is upheld, the hardware income be taxed on net basis by following 15% attribution to the profits of the Aspect US in India (i.e. Revenue x Attribution rate x Profit rate).

123. We have heard the rival contentions and perused the material on record. We see merit in the arguments of the learned counsel of the assessee. In the instant case, the AO has not provided the basis for attributing the income to the assessee's PE in India. Calculation of the profits attributable to a PE is a fact specific exercise which has to be computed considering the provisions of law and the precedents on the subjects.

124. The co-ordinate bench of this Tribunal in the case of Convergys Customer Management Group Inc. V ADIT (58 SOT 69) (Del) has held that an overall attribution of profits to the PE is a transfer pricing issue and no further profits can be attributed to a PE once an arm's length price has been determined for the Indian associate enterprise, which subsumes the functions, assets and risk profile of the allege PE. The above view was expressed by the bench considering the CBDT circular No.5 of 2004 dt.28-9-2004 as well as the ratio upheld by the Supreme Court in Morgan Stanley (Supra), the Bombay High Court in Set Satellite Singapore (P) Ltd. Vs. DIT, International Taxation (307 ITR 205), the jurisdictional High Court in Rolls Royce Singapore (P) Ltd.,

Vs. Asst. DIT (202 Taxman 45) and DIT Vs. BBC Worldwide Limited (203 Taxman 554) and the OECD guidelines.

125. In a recent decision, the Jurisdictional High Court in the case of DIT Vs. E Funds IT solutions (226 Taxman 44) reiterated the principle laid down in Morgan Stanley (supra) on attribution of profits to a PE and held that where a PE is held to exist, subject to the application of the force of attraction rule, only profits in relation to the assets and activities of the PE may be attributed to it and that an arm's length payment to a subsidiary PE as per FAR analysis would be sufficient for such attribution.

126. In view of the above, we agree with the learned counsel of the assessee that where an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk taking functions of the multinational enterprise, nothing further would be left to attribute to PE.

127. For A.Y.2003-04, 2004-05 and 2005-06, the transfer pricing analysis of Aspect India was referred to the Transfer Pricing Officer, TPO – 1(4), New Delhi u/s 92CA(3) of the Act. The TPO after due consideration of the services rpvided by Aspect India to Aspect US has held that the services were provided at Arm's Length Price. In respect of these A.Ys, as the TOP has held that the services are transacted at ALP, we fail to understand how a different view can be taken in the case of Aspect US who is a counterparty to the transactions. Further, S.92CA(4) requires the AO to consider the ALP determined by the TPO for computing the total income of the assessee. Thus, the order of the TPO is binding on the AO to the extent it is not prejudicial to the assessee. Accordingly, for AYs 2003-04 and 2004-05, we hold that no further income can be attributed to the PE in India.

128. For the other A.Ys under appeal, we direct the AO to refer the matter to the TPO wherever there is no existing reference either in the case of Aspect US or Aspect India. The TPO shall determine ALP and attribute the profits accordingly. In this regard, we place reliance in the case of Ranbaxy Laboratories Ltd. Vs. CIT (345 ITR 193, Del HC) wherein the validity of the instruction no.3 dt.25-5-2003 issued by the CBDT u/s 119 of the Income Tax Act was upheld and the reference to TPO for determination of ALP was considered mandatory.

Ground 10

129. Ground no.10 is on the claim for deduction of remuneration paid to the alleged P.E. from the profit attributed to the P.E.

130. The Learned Counsel for the assesee relied on Article 7 of the Tax Treaty and submitted that while determining the profits of the P.E. there shall be allowed as deduction, expenses which are incurred for the purpose of business of the PE including reasonable allocation of executive and general administrative expenses, research and development expenses, interest and other expenses incurred for the purpose of the enterprise as a whole whether incurred in India or elsewhere. Therefore, the AO ought to have allowed the remuneration paid to ACC as deduction for arriving at the taxable income. She argued that since Aspect US is remunerating to ACC at arm's length for the services rendered by it, deduction of the said expenses is crucial to determine the real income arising to the assessee. Disallowance of such expenditure would result in taxation of inflated incomes in the hands of the assessee. She pointed out that ACC is offering to tax the revenues received by it from the assessee company and hence non deduction of the same will result in double taxation. It was pointed out that in the draft assessment order the AO has

allowed the deduction and the DRP has also held that the AO rightly deducted the compensation paid by the assessee to ACC but however while passing the final assessment order the AO did not give the deduction for the said expenditure

131. The Learned CIT-DR submitted that the DRP in paragraph 6 of the order had held that the amount paid by the assessee to Aspect India qualifies as a deductible expenditure for the assesee. He argued that the issue of deduction of expenses is essentially and inextricably linked to the attribution of profits. In case, the Hon'ble Tribunal rejects the appeal of the assessee with respect to taxation of revenue from licensing of software and services then the revenue is taxable on gross basis both under the Act and the Tax Treaty and do not call for any deduction of expenditure. In such a situation only payments made to Aspect India for marketing of products shall be allowed as deduction and such deduction may be in line with the income that is attributed to the PE.

132. He further submitted in case of services the provisions of Article 12(6) will trigger and the provisions of Article 7 would apply since the support services are rendered through its PE. In that case, the revenue from services is attributable to the PE and expenses incurred by Aspect India in providing such services will qualify for deduction. However, the same would not apply to licensing of software unless the assessee demonstrates that such royalty income is attributable to the PE. In summary, the CIT-DR submitted that allowability of deduction of expenses incurred by Aspect India depends on the revenues that are taxable as business income. The expense incurred to earn such business receipts only are allowable as deduction and not full expenses as claimed by the assessee.

133. As we have directed the AO to refer the matter to the TPO for determining the ALP and thus decide on attribution of profits, we are of the view that this issue should also go back to the AO for fresh adjudication in accordance with law.

Ground 11, 11.1

134. The ground is on applicability of transfer pricing provisions and rejection of Transfer pricing analysis of Aspect India.

135. The AO held that the transfer pricing provisions are applicable to the assessee. Further, he rejected the Transfer Pricing analysis of Aspect India and thereby attributed further consideration to Aspect India. The DRP has upheld the AO rejecting the Transfer Pricing analysis of the Appellant.

136. The Learned Counsel for the assessee submitted that the sale transactions of the assessee cannot be termed as international transactions under the Act as there is no transaction between the two A.Es. She explained the nature of business and the types of transactions and argued that the transactions entered into by Aspect US, the channel partners/end customers do not attract transfer pricing provisions in India. She also disputed the rejection of transfer pricing analysis of Aspect India and she defended the TP study of the Subsidiary company and argued that no penalty can be levied u/s 271BA and 271 AA is not maintaining transfer pricing documentation.

137. The Learned CIT-DR submitted that there is no dispute that the assessee and ACT are associated enterprises. Further, the transactions in regard to rendering of services by ACT are international transactions. Therefore, the AO has rightly held the TP provisions are applicable to the assessee and it must

have strictly observed the compliance of these provisions including filing of report in Form no 3CEB as required by section 92E of the Act. It was also obliged to maintain the documentation as required by section 92 of the Act.

138. The assessee has objected to rejection of TP analysis of Aspect India. The AO has dealt this issue in detail and demonstrated that the TP analysis in case of Aspect India has not captured the FAR in regard to the international transaction between assessee and Aspect India. The information on functions performed has been obtained by the AO based on enquiries and statements employees of Aspect India recorded during the course of assessment proceedings. Most glaring omission in the TP analysis was with regard to functions performed by employees of Aspect India in regard to marketing and sales including deciding of prices of products of the assessee that are sold in India, Sri Lanka and the Middle East. The fact that Aspect India supports sales operations in countries outside India was unearthed during the enquiries conducted by the AO. Therefore, the AO has rightly rejected the TP analysis in case of Aspect India so far as it concerns Aspect software Inc. He argued that the findings of the AO stands on very sound footing and are based on unassailable reasons. Therefore this ground of the assessee is required to be rejected.

139. In her rejoinder, the Learned Counsel for the assessee submitted that the allegation of the Revenue that the Transfer Pricing analysis of Aspect India is defective since the FAR analysis has not been captured properly is not correct. It was submitted that the while comparing the functions, the AO has listed down certain clauses which are in no manner be held to be functions performed by ACC. The clauses quoted by the AO in the order do not in any way expand the scope of functions performed by ACC. Therefore, the functions identified in transfer pricing study are complete and exhaustive. Aspect India

has been remunerated at arm's length for functions provided by it. Accordingly, no further attribution is required to be made for Aspect US. She submitted that this is supported by the fact that tax return of Aspect India was picked up for scrutiny by the Transfer Pricing Officer ('TPO') for AY 2004-05, 2005-06 and AY 2008-09 and the TPO had accepted the value of international transaction declared by the assessee. In support of her submissions, she relied on the decision of the Hon'ble Supreme Court in the case of Morgan Stanley and Co. Inc (Supra).

140. Similar issues have been dealt with by us earlier in this order while dealing with attribution of profits to the PE. As the criteria for adjudication of both the issues is similar, consistent with the view taken by us we direct the assessing officer to accept the TPO analysis of Aspect India wherever the same is available.

Ground no.11.2, 11.3, 12

141. By way of this ground, the assessee has challenged initiation of penalty proceedings u/s 271BA (for non furnishing of TP report), 271AA (for non-maintenance of TP documentation) and 271(1)(c) of the Act. In our view it is premature to question the action at this stage as they are all independent proceedings outcome of which can be challenged if the assessee feels aggrieved. This ground is accordingly rejected.

Ground no. 13- Levy of interest under Sec 234B of the Act

142. The learned Counsel for the assessee has disputed the levy of interest u/s 234B of the Act placing reliance on the judgement of the Jurisdictional High Court in the case of DIT vs. Jacabs Civil Incorporated (330 ITR 578, Del HC) and other case laws on the subject. She also distinguished the decision of

Hon'ble Delhi High Court in the case of Alcatel Lucent USA Inc (330 ITR 578, Del HC).

143. The Learned CIT-DR opposed the contentions of the assessee and submitted that the assessee has not cooperated with the revenue authorities during the proceedings in assessment as well as proceedings before the DRP. He drew the attention of the Bench to the observations of the DRP in para 3. Ld.DR pointed out that the tax was deducted at source by the customers and payers in India on payments made to the assessee company and the assessee company is claiming refund of this tax deducted. The determination hinges on factual verification whether tax was deducted by payers on all amounts including purchase of hardware. Further, where tax is deducted and there is short deduction, it needs to be examined whether the assessee had any role in such short/ non deduction of tax.

144. He further submitted that it is not in dispute that the assesee has not offered the income from software licensing, sale of equipments and service fee to tax. It is disputing the taxability of these sources of income and continues to dispute even before the Hon'ble Tribunal. The facts of the present case are covered by the decision of the Hon'ble Delhi High Court in the case of Alcatel Lucent (Supra) and the decision of the Delhi ITAT in the case of Nortel India International Inc and Baker Hughes.

145. We heard the rival contentions. The issue stands covered by the decision of the High Court of Delhi in the case of Jacabs Civil Incorporated/Mitsubishi Corpn. (supra) where in the Hon'ble High Court held that section 195 puts an obligation on the payer i.e. any person responsible for paying any tax at source at the rates in force from such payments and if payer has defaulted in deducting tax at source, the department can take action against the payer

under the provisions of section 201. In such a case, the non- resident cannot be held liable to pay interest under section 234B on account of default of the payer in deducting tax at source from the payments made to the non-resident.

146. However in a subsequent decision in the Alactel Lucent, the Hon'ble Delhi High Court on a specific fact situation held that where non-resident assessee accepted its liability to be taxed in India at first appellate stage, all consequences under Act including liability to pay interest under section 234B would follow; assessee could not be permitted to shift responsibility to Indian payers for not deducting tax at source from remittances, after leading them to believe that no tax was deductible.

147. The learned CIT-DR heavily relied on the decision of Alcatel Lucent (Supra) to support the levy of interest under Sec. 234B of the Act.

148. The undisputed fact in the present case is that tax on the entire income received by the assessee was required to be deducted at appropriate rates by the respective payers under section 195(2). Had the payer made the deduction of tax at the appropriate rate, the net tax payable by the assessee would have been Nil.

149. In the case of Alcatel, Alcatel has not offered the income to tax while filing the tax return and also the deductees had not withheld tax on the same. However, in the present case, tax was deducted at source by the customers and payers in India on payments made to the assessee company and the assessee company is claiming refund of this tax deducted. The interest obligation has arisen on account of the AO holding ACC as PE of asseseee in India which

resulted in higher assessed income. Further, the Revenue has not brought anything on record to prove that the assessee has led the Indian payers to believe that tax was deductible at lower rates. Under these circumstances, we allow this ground in favor of the assessee.

150. In the result, all the appeals filed by the assesse for the Assessment Year 2003-04 is allowed in part.

151. With respect to the Cross Objections there is a delay in filing of the same. Further, after making submissions on the issue of Cross Objections for two days, the Ld.D.R. ultimately submitted that he is withdrawing the same. Hence we dismiss all the Cross Objections filed by the Revenue as being 'withdrawn'.

152. Before parting with the order, we wish to make an observation. While dealing with some of the grounds of appeal, we have extracted the rival contentions in an elaborate manner in spite of the fact that we have found it necessary to set aside those issues. This we have done so, as we expect that while reexamining the issues set aside by us all the aspects arising out of the rival contentions elaborated by us in our order will be considered and decided upon.

153. As stated by us at the beginning of this order, the issues involved in all the appeals are identical and hence the view taken by us in ITA No.221/Del/2013 for A.Y.2003-04 is applicable for appeals of all the other years. In the result, all the appeals filed by the assessee for the AYs 2003-04, 2004-05, 2007-08, 2008-09, 2009-10 and 2010-11 are partly allowed and the Cross Objections filed by the Revenue are dismissed as 'withdrawn'.

Order pronounced in the Open Court on 18th May, 2015.

Sd/-	Sd/-
(GEORGE GEORGE K)	**(J.SUDHAKAR REDDY)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: the 18th May, 2015

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Copy of the Order forwarded to:
1.Appellant;
2.Respondent;
3.CIT;
4.CIT(A);
5.DR;
6.Guard File

By Order

Asst. Registrar