IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A', HYDERABAD

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

ITA No. 918/Hyd/2010
Assessment Year: 2009-10

Asst. Director of Income-tax (International Taxation) – I, Hyderabad Appellant	vs.	M/s Bartronics India Ltd., Hyderabad. PAN – AAACB8231F Respondent

Revenue by: Sri P. Soma Sekhar Reddy
Assessee by: Sri P. Murali Mohan Rao

Date of hearing: 28/11/2013
Date of pronouncement: 27/01/2014

O R D E R

PER CHANDRA POOJARI, AM:

This appeal preferred by the Revenue is directed against the order of the CIT(A)-VI, Hyderabad dated 25/03/2010 for the assessment year 2009-10 wherein the Revenue has raised the following grounds of appeal:

> "*1. The Ld. CIT(A) erred in law and on the facts of the case.*
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> *2. The learned CIT(A) has erred in not appreciating the full facts of the case, nor has brought out on record the full facts from the assessee regarding non-submission of any agreement or delayed submission of the supplementary agreements.*
>
> *3 The ld. CIT(A) has erred in facts and law by holding that software and source code are two separate items of transactions whereas the source code is highly critical to any software having higher intrinsic value compared to a software application as a whole.*
>
> *4. The ld. CIT(A) has erred in laws treating the transaction as business income, whereas the transaction is actually in the nature of royalties and fees for technical services.*

5. The ld. CIT(A) has erred in laws by holding the royalties in Article 12 of DTAA (India and Singapore) or section 9 of IT Act as fees for technical services does not apply."

2. Briefly the facts of the case are that the assessee is a company engaged in the business of providing enterprise solutions based on smart cards, bar coding, biometrics etc. A survey u/s 133A was conducted on 11/02/2009 in the business premises of the assessee by the Department to verify the TDS payments made by the assessee. It was noticed by the Assessing Officer that an amount of USD 2,00,57,969 (INR 97,41,67,421/-) and USD 19,82,454 (INR 9,67,88,361/-) had been accounted as payable/paid to Gamma Machinery and Equipments PTE Ltd., Singapore (GAMMA) and Intra Asia Trading Pte Ltd., Singapure (Intra) for the purpose of complete source code for contact/contact less smart cards operating systems for transport application, conforming to National Informatics Centre, Govt of India standards with Intellectual Property Rights along with necessary development, testing, soft and hard masking process instructions and user documentation for various companies IC Modules/Micro controller range of various EEPROM sizes. The ADIT, after ascertaining the details, finally concluded that the above amounts payable/paid by the assessee company is liable for TDS u/s 195 of the IT Act and accordingly worked out the liability u/s 201(1) and interest u/s 201(1A). The details of amounts paid to the foreign companies and TDS liability u/s 201(1) and interest u/s 201(1A) determined by the ADIT were as under:-

Name of the foreign company	Payment grossed up (Rs.)	TDS Liability u/s 201(1)	Interest u/s 201(1A)
Intra Asia Trading Pte Ltd., Singapore	107542623	10754262	322628
Gamma Machinery & Equipments Pte Ltd., Singapore	1082408246	108240825	6494449
Total		118995087	6817077

Aggrieved, the assessee carried the matter in appeal before the CIT(A).

3. Before the CIT(A), it was submitted that the business of the assessee is covered by articles 7 and 5 of DTAAs and under article 7 of the DTAAs, income earned by a non-resident in India under the head 'business' can be taxed in India only if the non-resident has a 'permanent establishment' (PE) in India. "Permanent establishment' itself is defined in article 7, and it means a permanent branch or a permanent office located in India. If the business is carried on through employees and if those employees stay in India for less than 183 days in the cases of Singapore there will be non PE in India and the corresponding business profit of the non-resident becomes non-taxable.

3.1 Further, it was submitted that none of the two foreign parties has a PE situated in India, since none of them have a branch or an office in India and, therefore, in the absence of a PE there can be no taxable business profit arising in India for any of the above foreign parties, in view of Article 7 of each of the DTAAs. It was also submitted that though the services rendered by the Singapore individual must be considered as independent personal services, as an alternative submission, it should be considered under the head business. Since there is no PE for any of these parties in India, the business income is exempt from taxation under article 7 read with article 5.

3.2 Without prejudice to the above submissions, it was submitted that the rates of tax adopted by the Assessing Officer are not in accordance with the DTAA rates.

3.3 Further, it was submitted that the applications of smart cards in various field such as banks and social segment is universal and software relating to the application are developed by the software developers matching the requirement and made available to the buyers as tailor-made-off shelf products. Thus, the acquisition/purchase of the set is a product along with the attached IP rights distinguished clearly and paid accordingly and accounted accordingly. It was submitted that the assessee is under the impression that the payments made squarely fall under goods. It was finally submitted that as there is no income deemed to be accrued or arise in India out of the above and it is being business profit for the non-resident company and as there is no permanent establishment exist in India, the provisions of section 195 and section 201 of the IT Act are not applicable to the assessee company and tax deduction does not arise. The assessee relied on various case laws before the CIT(A) which were extracted by the CIT(A) at pages 15 to 21 of the impugned order.

4. The CIT(A) after considering the submissions of the assessee as well as the submissions of the ADIT during appellate proceedings, discussed the issue elaborately with various case laws from paras 6 to 7 spread over pages 21 to 55 and held that the amounts paid to Intra Asia Trading Pvt. Ltd., Singapure and Gamma Machinery and Equipments Pte Ltd., Singapore, towards purchase of software do not attract TDS. The concluding paras of CIT(A) are as under:

> "8.0 *On the factual findings of the ADIT in the facts and circumstances of the case, the AR strongly objected to the same and contended that the appellant is not liable to deduct taxes u/s 195(1) of the Act. On a careful perusal of the order u/s 201(1) of the ADIT and the supplementary agreements entered into by the parties I am of the considered opinion that the ADIT is not entirely correct in his approach. In the case of TATA Consultancy Services Vs. State of AP [2004] 271 ITR 401 9SC), the Hon'ble Supreme Court observed that the 'intellectual property' incorporated on media for the purpose of transfer should be considered as sale of good under the APGST Act. In the normal circumstances, cases decided under sales tax law are not applicable to income tax law. However, the aforesaid case law is relied only for the limited proposition that intellectual property incorporated on media for the purpose of*

transfer should be considered as sale of goods. In the present case, the ADIT having accepted that the foreign companies transferred the software to the appellant in their capacity as trading agencies and intermediaries, it cannot be said that they have parted with their exclusive rights entitling them with royalty. It cannot also be said that the same would constitute fees for technical services paid to the foreign companies as consideration for rendering of technical services associated with the 'source code' for smart card operating system and related technical services for the same reason that the foreign companies involved in the transaction merely transferred the stock in trade held by them in their regular course of business without rendering any technical services.

8.1 Thus, the appellant as well as the foreign companies acted on the agreements entered into by them. The appellant company made the outright purchase on their own account and those transactions were supported by proper documents such as invoices, shipping documents etc. Therefore I am of the view that improper analysation of the facts by the ADIT(IT) led him to an improper conclusion that in respect of a package transaction which is now under consideration the entire amount has to be considered either as 'royalty' or 'fees for technical services'. Thus, the ADIT(IT) missed the track from sum and substance of the transaction involving purchase of products under different agreements. In view of that, the supplementary agreement alone will make the foreign companies liable to tax for the purpose of Indian Income Ta Act, 1961 which consequently make the appellant liable u/s 195(1) for the payment made by it towards Intellectual Property Rights Source Code. On the other hand, payments made for purchase of the software itself being covered as the sale of goods and hence the same cannot be subject to tax for the purchase of software which is outside the purview of taxation of withholding tax.

8.2 In earlier part of this order, I have already held that the amount involved in this transaction constitute business income of the foreign companies and not liable for deduction of tax at source u/s 195(1) of the IT Act and since the payments involved were identified as 'buiness income' of the foreign companies the question of giving a finding regarding rate of tax applicable for these transactions does not arise.

8.3 Considering the facts and circumstances of the case, the transaction under the consideration effected by the appellant should be considered as business transaction as envisaged under Article 7 of Ind-Singapore DTAA. Since the appellant has brought a readymade off the shelf computer programme which does not grant any right to utilize the copy right of the computer programme, I am of the view that the payments made by the *appellant company cannot be held as 'royalties' coming into the ambit of Article 12 of DTAA or 'fee for technical services' u/s 9(1)(vii) of IT Act and accordingly no tax need to be deducted u/s 195 of the IT Act.*

9. In view of the above, I hold that the amounts paid to Infra Asia Trading Pvt. Ltd., Singapore and Gamma Machinery and Equipments Pte Ltd., Singapore towards purchase of software does not attract TDS or withholding tax on the following amounts:

1. Payments to Gamma Machinery – Rs. 97,41,67,421 [$20057969]
2. Payment to Infra Asia Trading - Rs. 9,67,88,361 [$1982454]"

5. Aggrieved, the revenue is in appeal before us.

6. Before us, the learned DR submitted that the consideration paid by the assessee company for the 'source code(s)' of the smart card operating systems is characterised as 'royalties' as per the DTAA, as the consideration is for the use or right to use the secret formula or process and also 'for information concerning industrial, commercial or scientific experience'. It was further submitted that the said consideration also falls within the definition of 'fees for technical services' as defined in the treaty. It was also submitted that as per paras 1 and 2 of the Article 12, the royalties or fees for technical services arising in a contracting state (India) may also be taxed in the contracting state in which they arise according to the laws of that state, and provided if the beneficial owner of the royalties is a resident of the other contracting state (Singapore), the tax so charged shall not exceed 10 per cent of the gross amount of the royalties.

6.1 The DR submitted that section 195 of the IT Act, 1961 puts responsibility on the person responsible (Batronics or its Principal officer) for paying to a non-resident (Intra/Gamma), to deduct tax on the sum chargeable to tax. Further it was submitted that from the above provisions, it is clear that the deductor-assessee was very much required to make deduction of tax at source while making payment on account of the transactions under consideration. It was contended that since the assessee had not made any such deduction of tax while making the remittance to the non-resident and as such the deductor assessee is liable for the consequences of its failure to deduct tax and, therefore, the Assessing Officer has rightly made the addition u/s 201(1) and 201(1A) of the Action.

7. On the other hand, the learned counsel for the assessee has filed detailed written submissions, which are as under:

a) The provisions of Section 195 of the Income Tax Act, 1961 are not applicable in the respondent's case.

As submitted in the foregoing paras, the AO has raised the demand in dispute by invoking the provisions of Sections 195 of the Income Tax Act, 1961. In this connection, it is submitted that the very provisions of Section 195 are not applicable to the assessee herein for the impugned payments are made to non-resident foreign companies which are not covered by the provisions of Section 195 of the I.T. Act, 1961. Ground was taken by the assessee herein before the 1st appellate authority on this issue and the assessee herein relied on the order of the CIT (Appeals) in **Para Nos. 7.2 to 9 at page Nos. 37 to 57** of his order.

b) **The payments under consideration are "Business Incomes" of the Non- Resident Companies.**

The AR submitted that the provisions of Section 195 of the Act are not applicable to the assessee herein, since **the payments under consideration constituted "Business Income" of the non- resident companies.** This fact is very much accepted by the AO vide **clause (5) of Para No.5 at Page Nos. 21 and 22** of his order. The relevant extract from the assessment order is as under:

"5) the Company's argument that the payment under consideration constitute "business income" of the non-resident is valid, considering the fact that **the non resident is in the business of trading in the 'unique source code items' held as stock in trade or in the business of rendering of services in the realm of software and related technology, as the case may be. As such the 'business income' of the non-resident recipient would be chargeable under the head 'profits and gains of business or profession' as per the Income Tax Act,** 1961. **The company also rightly observed that if there is no 'permanent establishment' (PE) in India for that non-resident, there will be no taxable income accruing in India as per Articles 7 and 5 of the DTAA.** But a thorough reading of Article 7 gives the understanding that **"where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article" (para** 7). In the instant case though the consideration for the source code for the smart card operating system constitutes 'business profit' of the non-resident, the same consideration can also be characterised as 'royalties' or 'fees for technical services', as the case may be. In such a situation, where the business income/profit of the non-resident include 'royalties' or 'fees for technical services', the taxability of these items of income shall be governed by the Article 12 of the DTAA with Singapore. This is in sync with the principle *'Generalia specialibus non-derogant'* which lays down that 'general provisions' will not override the 'special provision'. In the case of the company, the provisions dealing with 'royalties' or 'fees for technical services' under the Act as well as DTAA are 'special provisions' and should be given effect to the extent of its scope, leaving the general provision to control cases where specific provisions do not apply."

While accepting that the impugned payments constitute the "Business income of the non-resident companies, the AO has taken a 'U' turn by observing that same consideration can also be characterised as "Royalties" or "Fees for technical services", as the case may be. This view of the AO is vague and baseless. There is no ambiguity in the statue in this regard. The application of the principle of *'Generalia Specialibus non-derogant'* is mis-quoted in the assessee's case. Even if the second view taken by the AO were to be considered for argument sake, the AR submitted that if two reasonable constructions of a taxing provision are possible, that construction which favours the assessee must be adopted. This is well accepted rule of construction recognised by the Supreme Court in the case of CIT vs Vegetable Products Ltd (1973) 88 ITR 192 (SC).

In this regard, the assessee herein, relied on the observation of the CIT (Appeal) in para Nos. 6.0, 6.1, 6.2, 6.3, 6.4, 6.5 and 6.6 at page numbers 21 to 26 of his order.

c) <u>There is no need to AO to traverse beyond Article No 7 of the DTAA between India and Singapore and examine the impugned transactions in the light of Article No 12 of the DTAA.</u>

The AR submitted that the assessee here in has acquired from the non-resident companies "a readymade off the shelf computer programme to be used in its business and that 'no right' has been granted to the assessee here in to utilize the copy right of the programme. Since in the impugned transactions, a computer programme called "Software" has been purchased, the consideration cannot be treated as, "Royalty". In support of this, the respondent here in has relied on the following case laws:

1. CIT Vs Neyveli Lignite Corporation Ltd [2000] 243 ITR 459 (Mad).
2. Sonata software Ltd Vs. Income Tax Officer [2006] 6 SOT 700 (Bang).
3. Mphasis BFL Ltd. Vs Income Tax Officer [2006] 9 SOT 756 (Bang).
4. Lucent Technologies Hindustan Ltd Vs. Income Tax Officer [2005] 92 ITO 366 (bang).

The above mentioned case laws and the issue have been discussed by the CIT(Appeals) in para Nos. 6.6 to 6.8 at page Nos. 24 to 29 of his order. The assessee herein relies on the observations of the CIT(Appeals).

d) <u>AO's observations of failure on the part of the respondent here in to bring on record the original developer of the source code have no merit.</u>

The AR submitted that vide Para No. 4.11 at page No. 14 of his order, the AO observed, among other things, that the respondent here in having obtained the "Source Code(s)" from INTRA/GAMMA (the non resident company) a mere trading house, which is neither a developer nor a business house expertised in development of software/computer programme, failed to bring on record the original developer, who developed the 'Source Code' for operating systems and that it was unable to bring on record on what terms and conditions the "Source Code" was produced by INTRA/GAMMA from the original developer /owner of the "Source Code".

In this connection, the AR submitted that the assessee here in has no obligation to bring on record either the original owner or the terms and conditions for producing the source code to the non-resident companies. In this regard, the AR relies on the observations of the CIT (Appeals) vide para Nos. 6.9 at pages 28 and 29 of his order.

e) "Software" and "Source code" are two separate items of transaction

The AR submitted that the observation of the AO that "Software" and "Source code" are not two separate items, the AO has not taken into consideration the supplementary agreements filed before him during the course of assessment proceedings. The supplementary agreements clearly show the bifurcation of the payments towards "Software" and the "Source code". The reasons for rejecting the plea of the assessee herein on the bifurcation of the payments as given by the AO have no basis. Merely because there is no bifurcation shown in the invoices and there is no reference to the bifurcation in the statements of the key managerial/technical personnel, the bifurcation in the nature of payments cannot be denied especially in view of the Agreements and Supplementary agreements existing in support of the bifurcation. Also, merely because the assessee herein failed to make available to the Department any communication (e-mail, etc) on the price negotiated, it cannot be inferred that there is no bifurcation in the payments.

The AR submitted the agreement copies and supplementary agreement copies were furnished before the AO during the course of assessment proceedings. The observation of the AO in **Para No. 4.10 at page 13** of his order that the fact that the" Supplementary Agreement" was signed and agreed by the contracting parties makes no difference, given the fact that the delivery of the "Unique Source Code set(s)" and consideration thereof were settled between the parties and as such there was no purpose for the parties to revise their agreement to avoid tax as the said transaction was being scrutinized by the department has no basis.

With regard to the observations of the AO in para no.4.7 at page no.1 0 of the impugned order, the AR submitted that the statements of the representative of the respondent company herein and the existence of the supplementary agreements have already been considered by the Ld. CIT(Appeals) in his appellate order.

In this regard, the assessee herein relies on the observations of the CIT(Appeals) in **para Nos. 6.10 and 6.11 at page Nos. 29 to 33** of his order.

(f) Decision of Karnataka High Court in the case of CIT(Intl.Taxation) vs. Samsung Electronics Co. Ltd.! [185 Taxman 3131 (Kar) is distinguishable.

During the course of appeal proceedings before the CIT(A), the AO relied on the above mentioned case law. He submitted that the judgment of Karnataka High Court in the above mentioned case cannot be made applicable to the case of the assessee herein since it is distinguishable on facts.

The AR relied on the observations of the CIT(Appeals) in Para Nos. 7.0 &7.1 at page Nos. 34 to 37 of his order.

(g) Decision of Delhi High Court in the case of DCIT vs. Infra Soft Ltd [2013] 39 Taxmann.com 88 (Delhi) is applicable.

I. The Delhi High Court upheld the order of the Tribunal that amount received by the assessee under the license agreement for allowing the use of the software would not be royalty under the DTAA.

11. It held that what was transferred was neither the copy right in the software nor the use of the copy right in the software, but what was transferred was the right to use the copy righted material or article which was distinguishable from the rights in a copy right.

III. It further held that the right that was transferred was not a right to use the copy right but was only limited to the right to use the copy righted material and the same would not give rise to any royalty income and would be business income.

IV. The Delhi High Court also expressed its disagreement with the decision of the High Court in the case of CIT vs. Samsung Electronics Co. Ltd., [2011] 203 Taxman 477 (Kar) that right to make a copy of the software and storing the same in the hard disk of the designated computer and taking backup would amount to copy right work.

The AR submitted that the above decision of Delhi High Court is squarely applicable to the case of the respondent here in.

(h) <u>There is no taxable income accrued to the non-resident parties.</u>

The AR submitted that on account of the impugned transactions of the respondent here in with Infra Asia Trading **PTE** Ltd., Singapore and GAMMA Machinery and equipments **PTE** Ltd Singapore, no taxable income accrued to them and consequently there is no need to deduct tax at source u/s 195 of the I.T.Act, 1961.

In this regard, the AR relied on the observations of the CIT(Appeals) in Para No. 5.0 at page Nos. 10 to 21 of his order.

In the light of the above submissions, the AR prayed that the order of the CIT(A) may be upheld.

8. We have heard the arguments of both the parties, perused the record and have gone through the orders of the revenue authorities. The Assessing Officer held that the assessee company defaulted under the provisions of section 195(1) while making payment to foreign companies, namely i) Intra Asia Trading Pte Ltd. and Gamma Machinery and Equipments Pte Ltd., Singapore, for acquiring intellectual property rights and the smart card operating system software and, therefore, failure in violating the provisions of section

5(2)(b) read with section 9(1)(vi) or 9(1)(vii) of the IT Act, the assessee was liable to be treated as "assessee in default" as per section 201(1) of the Act. Accordingly, the ADIT determined the TDS liability u/s 201(1) and interest u/s 201(1A) for Intra Asia Trading Pte Ltd and for Gamma Machinery and Equipment Pte Ltd. Rs. 11,89,95,087/- and Rs. 68,17,077/-. The contention of the AR is that as the assessee does not have any patents or copy rights for the products purchased and it clearly indicates that the products are for the business purpose of the assessee and, therefore, would not come into the ambit of section 195(1) of the Act. The AR contended that the transactions effected by the assessee with foreign companies are in the light of various clauses embedded in the general agreement as well as supplementary agreement entered into by the assessee. The amounts paid by the assessee would constitute business income in the hands of foreign companies and, therefore, not liable for tax deduction at source u/s 195 of the IT Act. The CIT(A) after considering the submissions of the assessee and the ADIT thoroughly examined and discussed the issue in dispute with various case laws and gave a categorical finding that "*the appellant as well as the foreign companies acted on the agreements entered into by them. The appellant company made the outright purchase on their own account and those transactions were supported by proper documents such as invoices, shipping documents etc. Therefore he was of the view that improper analysation of the facts by the ADIT(IT) led him to an improper conclusion that in respect of a package transaction which is now under consideration the entire amount has to be considered either as 'royalty' or 'fees for technical services'. Thus, the ADIT(IT) missed the track from sum and substance of the transaction involving purchase of products under different agreements. In view of that, the supplementary agreement alone will make the foreign companies liable to tax for the purpose of Indian Income Tax Act, 1961 which consequently make the appellant liable u/s 195(1) for the payment made by it towards Intellectual Property Rights Source Code. On the* *other hand, payments made for purchase of the software itself being covered as the sale of goods and hence the same cannot be subject to tax for the purchase of software which is outside the purview of taxation of withholding tax."*

9. We find from the order of the ADIT u/s 201(1), that the ADIT agreed with the view of the assessee company that the payment under consideration constituted 'business income' of the non-resident was valid considering the fact that the foreign companies were in the business of trading in the 'unique source code' item held as 'stock in trade' and in the absence of permanent establishment, there will not be taxable income accruing in India as per Articles 7 & 5 of Indo-Singapore DTAA. However, the ADIT observed that as the same consideration can be considered as 'royalties' or fees for technical services' as the case may be, the taxability of those items of income should be governed by the Article 12 of the DTAA. We are of the view that the transaction effected by the assessee would come into the ambit of Article 7 of the DTAA between India and Singapore, therefore, there is no need for the Assessing Officer to traverse beyond that article and examine the transaction in the light of Article 12. The article 7(1) & 7(5) of the DTAA with Singapore are as under:

> "*7(1). The income or profit of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carried on business as aforesaid, the income or profits of the enterprise may be taxed in the other Contracting State but only on so much of such income or profits as is attributable to that permanent establishment.*
>
> *7(5) For the purpose of this article, the term 'income or profits' means income derived by an enterprise form the conduct of a trade or business; but does not include income derived by an enterprise in the form of rents, royalties, technical, services fee, interest, dividends, capital gains, fees for the management of the business of another enterprise, or remuneration or fee received by an enterprise for the furnishing to another enterprise of the services of its technical, skilled or other*

personnel except where the property or other right giving rise to any such item of income is effectively connected with the permanent establishment of the enterprise. The term 'income or profits' shall not also include income from the operation of ships or aircraft'.

10. We have also gone through the Article 12 of the DTAA with Singapore stipulates as under:

ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical sevices may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed:

   a. in the case of royalties referred to in paragraph 3(a) and fees for technical services as defined in this Article (other than services described in sub-paragraph (b) of this paragraph), 15 per cent. of the gross amount of the royalties and fees;

   b. in the case of royalties referred to in paragraph 3(b) and fees for technical services as defined in this Article that are ancillary and subsidiary to the enjoyment of property for which royalties under paragraph 3(b) are received, 10 per cent. of the gross amount of the royalties and fees.

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

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

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

4. The term "fees for technical services" as used in this Article means payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) 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, which enables the person acquiring the services to apply the technology contained therein; or

c. consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.

For the purposes of (b) and (c) above, the person acquiring the service shall be deemed to include an agent, nominee, or transferee of such person.

5. Notwithstanding paragraph 4, "fees for technical services" does not include payments:

a. for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than a sale described in paragraph 3(a);

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

c. for teaching in or by educational institutions;

d. for services for the personal use of the individual or individuals making the payment;

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

f. for services rendered in connection with an installation or structure used for the exploration or exploitation of natural resources referred to in paragraph 2(j) of Article 5;

g. for services referred to in paragraphs 4 and 5 of Article 5.

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, a statutory body or a resident of that State. Where, however, the person paying the royalties or fees for technical 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 technical services was incurred, and such royalties or fees for technical services are borne by such permanent establishment or fixed base, then such royalties or fees for technical services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

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

10.1 Clause 1 of Article 12 lays down that royalty or fees for included services arising in a contracting State and paid to a residents of the other contracting State may be taxed in that other state.

11. Clause 2 of Article 12 lays down that royalty and fees for included services may also be taxed in a contracting State in which they arise. However, if the beneficial owner of the royalties or fees for included services paid to the residents of the other contracting State then the tax has been limited in percentage depending upon the number of years the convention has effect.

12. Clause 3 of Article 12 lays down that the term royalty means payment of any kind received as consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work.............., including gains derived from the alienation of any such right, property or information. The term royalty has been defined by clause 3 of Article 12 as payment received for the use of, or the right to use any copyright.

13. The amount received by the Assessee company had been treated as royalty income by the AO on the basis of Explanation 2 to Section 9(1)(vi) of the Act holding that there was transfer of some rights (including the granting of a licence) in respect of the copyright.

14. What is thus required to be examined is whether income of the Assessee is royalty income as covered by Article 12 of the DTAA if not then the same would be taxable as business income as covered by the provisions of Article 7 of the DTAA.

15. To be taxable as royalty income covered by Article12 of the DTAA the income of the Assessee should have been generated by the "use of or the right to use of" any copyright.

16. The issue whether consideration for software was royalty came up for consideration before the Special Bench of the Tribunal in Delhi in the case of MOTOROLA INC VS DEPUTY CIT (2005) 147 TAXMAN 39 (DELHI). The Tribunal has held as under:

> 155. It appears to us from a close examination of the manner in which the case has proceeded before the Income-tax authorities and the arguments addressed before us that the crux of the issue is 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. This issue really is the key to the entire controversy and we may now proceed to address this issue.
>
> 156. We must look into the meaning of the word "copyright" as given in the Copyright Act, 1957. Section 14of this Act defines "Copyright" as "the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely:
> ---------
> It is clear from the above definition that a computer programme mentioned in Clause (b) of the section has all the rights mentioned in Clause (a) and in addition also the right to sell or

give on commercial rental or offer for sale or for commercial rental any copy of the computer programme. This additional right was substituted w.e.f. 15.1.2000. The difference between the earlier provision and the present one is not of any relevance. What is to be noted is that the right mentioned in Sub-clause (ii) of Clause (b) of Section 14is available only to the owner of the computer programme. It follows that if any of the cellular operators does not have any of the rights mentioned in Clauses (a) and (b) of Section 14, it would mean that it does not have any right in a copyright. In that case, the payment made by the cellular operator cannot be characterized as royalty either under the Income-tax Act or under the DTAA. The question, therefore, to be answered is whether any of the operators can exercise any of the rights mentioned in the above provisions with reference to the software supplied by the Assessee.

157. We may first look at the supply contract itself to find out what JTM, one of the cellular operators, can rightfully do with reference to the software. We may remind ourselves that JTM is taken as a representative of all the cellular operators and that it was common ground before us that all the contracts with the cellular operators are substantially the same. Clause 20.1 of the Agreement, under the title "License", says that JTM is granted a non-exclusive restricted license to use the software and documentation but only for its own operation and maintenance of the system and not otherwise. This clause appears to militate against the position, if it were a copyright, that the holder of the copyright can do anything with respect to the same in the public domain. What JTM is permitted to do is only to use the software for the purpose of its own operation and maintenance of the system. There is a clear bar on the software being used by JTM in the public domain or for the purpose of commercial exploitation.

158. Secondly, under the definition of "copyright" in Section 4 of the Copyright Act, the emphasis is that it is an exclusive right granted to the holder thereof. This condition is not satisfied in the case of JTM because the license granted to it by the Assessee is expressly stated in Clause 20.1 as a "non exclusive restricted license". This means that the supplier of the software, namely, the Assessee, can supply similar software to any number of cellular operators to which JTM can have no objection and further all the cellular operators can use the software only for the purpose of their own operation and maintenance of the system and not for any other purpose. The user of the software by the cellular operators in the public domain is totally prohibited, which is evident from the use of the words in Article 20.1 of the agreement, "restricted" and "not otherwise". Thus JTM has a very limited right so far as the use

of software is concerned. It needs no repetition to clarify that JTM has not been given any of the seven rights mentioned in Clause (a) of Section 14or the additional right mentioned in Sub-clause (ii) of Clause (b) of the section which relates to a computer programme and, therefore, what JTM or any other cellular operator has acquired under the agreement is not a copyright but is only a copyrighted article.

159. Clause 20.4 of the supply contract with JTM is as under:

20.4 In pursuance of the foregoing JT MOBILES shall:

(a) not provide or make the Software or Documentation or any portions or aspects thereof (including any methods or concepts utilized or expressed therein) available to any person except to its employees on a "need to know" basis;

(b) not make any copies of Software or Documentation or parts thereof, except for archival backup purposes;

(c) when making permitted copies as aforesaid transfer to the copy/copies any copyright or other marking on the Software or Documentation.

(d) Not use the Software or Documentation for any other purpose than permitted in this Article 20, Licence or sell or in any manner alienate or part with its possession.

(e) Not use or transfer the Software and/or the Documentation outside India without the written consent of the Contractor and after having received necessary export or re-export permits from relevant authorities. This clause places stringent restrictions on the cellular operator so far as the use of software is concerned. It first says that the cellular operator cannot make the software or portions thereof available to any person except to its employees and even with regard to employees it has to be only on a "need to know basis" which means that even the employees are not to be told in all its aspects. What the Assessee can do is only to tell the particular employee what he has to know about the software for operational purposes. The cellular operator has been denied the right to make copies of the software or parts thereof except for archival backup purposes. This means that the cellular operator cannot make copies of the software for commercial purposes. This condition is plainly contrary to Section 14(a)(i) of the Copyright Act which permits the copyright holder to reproduce the work in any material form including the storing of it in any medium by electronic means. We may also notice Section 52(1)(aa) of the Copyright Act which lists out certain acts which cannot be considered as infringement of copyright. The particular clause permits the making of copies or adaptation of a computer programme by the lawful possessor of the copy and the computer programme in order to utilize the public programme for the purpose for which it was supplied or to make backup copies purely as a temporary protection against loss, destruction or damage. Therefore, merely because the cellular operator has been permitted to take copies just for backup purposes, it cannot be said that it has acquired a copyright in the software.

160. Clause 20.4(c) makes it mandatory for the cellular operator, while making copies of the software for backup purposes, to also mark the copied software with copyright or other marking to show that the rights of the Assessee are reserved. This is one more indication that what the cellular operator acquired is not a copyright.

161. Clause 20.4(d) says that the cellular operator cannot use the software for any other purpose than what is permitted and shall not also license or sell or in any manner alienate or part with its possession. This has to be read with Clause 20.5 which says that the license can be transferred, but only when the GSM system itself is sold by the cellular operator to a third party. This in a way shows that the software is actually part of the hardware and it has no use or value independent of it. This restriction placed on the cellular operator (not to license or sell the software) runs counter to Section 14(b)(ii) of the Copyright Act which permits a copyright holder to sell or let out on commercial rental the computer programme. For this reason also it cannot be said that JTM or any cellular operator acquired a copyright in the software.

162. A conjoint reading of the terms of the supply contract and the provisions of the Copyright Act, 1957 clearly shows that the cellular operator cannot exploit the computer software commercially which is the very essence of a copyright. In other words a holder of a copyright is permitted to exploit the copyright commercially and if he is not permitted to do so then what he has acquired cannot be considered as a copyright. In that case, it can only be said that he has acquired a copyrighted article. A small example may clarify the position. The purchaser of a book on income-tax acquires only a copyrighted article. On the other hand, a recording company which has recorded a vocalist has acquired the copyright in the music rendered and is, therefore, permitted to exploit the recording commercially. In this case the music recording company has not merely acquired a copyrighted article in the form of a recording, but has actually acquired a copyright to reproduce the music and exploit the same commercially. In the present case what JTM or any other cellular operator has acquired under the supply contract is only

the copyrighted software, which is an article by itself and not any copyright therein.

163. We may now briefly deal with the objections of Mr. G.C. Sharma, the learned senior counsel for the Department. He contended that if a person owns a copyrighted article then he automatically has a right over the copyright also. With respect, this objection does not appear to us to be correct. Mr. Dastur filed an extract from Iyengar's Copyright Act (3rd Edition) edited by R.G. Chaturvedi. The following observations of the author are on the point:

"(h) Copyright is distinct from the material object, copyrighted:

It is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. The copyright owner may dispose of it on such terms as he may see fit. He has an individual right of exclusive enjoyment. The transfer of the manuscript does not, of itself, serve to transfer the copyright therein. The transfer of the ownership of a physical thing in which copyright exists gives to the purchaser the right to do with it (the physical thing) whatever he pleases, except the right to make copies and issue them to the public" (underline is ours).

The above observations of the author show that one cannot have the copyright right without the copyrighted article but at the same time just because one has the copyrighted article, it does not follow that one has also the copyright in it. Mr. Sharma's objection cannot be accepted.

164. It is not necessary, therefore, to consider the alternative argument of Mr. Dastur, namely, that even assuming that the Department is right in saying that if you have the copyrighted article, you also have the copyright right therein, still it would mean that the copyright rights are transferred (acquired by JTM) and it would not be a case of merely giving the right to use and consequently Article 13 of the DTAA would not apply. Mr. Dastur, however, was fair enough to concede that if the Department is right in saying that if you have the copyrighted article, you also have the copyrighted rights, then Clause (v) of Explanation 2 below Section 9(1) of the Income-tax Act will apply because this clause ropes in "transfer of all or any rights" and is not restricted to "use" or "right to use", the copyright. However, he added that since the basic proposition of the Department has been demonstrated to be wrong, Clause (v) of Explanation 2 below Section 9(1) is not an impediment to accepting the assessee's contention.

165. We may also usefully refer to the Commentary on the OECD Model Convention (dated 28.1.2003) which is of persuasive value and which throws considerable light on the character of the transaction and the treatment to be given to the payments for tax purposes. Paragraph 14 of the Commentary, a copy of which was filed in Paper book No. V is relevant:

COMMENTARY ON ARTICLE 12 - PAPER BOOK V

"14. In other types of transactions, the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program, for example, where the transferee is granted limited rights to reproduce the program. This would be the common situation in transactions for the acquisition of a program copy. The rights transferred in these cases are specific to the nature of computer programs. They allow the user to copy the program, for example onto the user's computer hard drive or for archival purposes. In this context, it is important to note that the protection afforded in relation to computer programs under copyright law may differ from country to country. In some countries the act of copying the program onto the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of many countries automatically grant this right to the owner of software which incorporates a computer program. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, 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 commercial income in accordance with Article 7."

166. We may also usefully refer to the proposed amendments to the regulations of the Internal Revenue Service (IRS) in the USA. Again these regulations may not be binding on us but they have a persuasive value and throw light on the question before us, namely the difference between a copyright right and a copyrighted article. These regulations have been placed at pages 136 to 157 of Paper book No. II. The actual regulations as well as the explanatory Note explaining the object and the purpose of the proposed regulations have also been given. In paragraph 1 of the Note titled "Background", it has been stated that the proposed regulations require that a transaction involving a computer programme may be treated as being one of the four possible categories. Two such categories are the

transfer of copyright rights and the transfer of a copyrighted article. The U.S. regulations distinguished between transfer of copyright rights and transfer of copyrighted articles based on the type of rights transferred to the transferee. Briefly stated, if the transferee acquires a copy of a computer programme but does not acquire any of the rights identified in certain sections (of the U.S. Regulations), the regulation classified the transaction as the Transfer of a copyrighted article. Paragraph 3 of the Explanatory Note says that if a transfer of a computer programme results in the transferee acquiring any one or more of the listed rights, it is a transfer of a copyright right.

167. Paragraph 4 says that if a person acquires a copy of a computer programme but does not acquire any of the four listed copyright rights, he gets only a copyrighted article but no copyright.

168. The actual regulations bring out the distinction very clearly between the copyright right and a copyrighted article. They also specify the four rights which, if acquired by the transferee, constitute him the owner of a copyright right. They are:

(a) The right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending.

(ii) The right to prepare derivative computer programmes based upon the copyrighted computer programme

(iii) The right to make a public performance of the computer programme.

(iv) The right to publically display the computer programme.

169. A copyrighted article has been defined in the regulation (page 147 of the paper book) as including a copy of a computer programme from which the work can be perceived, reproduced or otherwise communicated either directly or with the aid of a machine or device. The copy of the programme may be fixed in the magnetic medium of a floppy disc or in the main memory or hard drive of a computer or in any other medium.

170. So far as the transfer of copyrighted articles and copyright rights are concerned, the regulation goes on to say (page 148 of the paper book) that the question whether there was a transfer of a copyright right or only of a copyrighted article must be determined taking into account all the facts and circumstances of the case and the benefits and burden of ownership which have been transferred. Several examples have been given below these regulations to find out whether a particular transfer

is a transfer of a copyright right or a transfer of a copyrighted article.

171. The Commentary of "Charl P. du TOIT" on this question has been placed at pages 202 to 204 of Paper book No. II. The Commentary is titled "Beneficial ownership of royalties in Bilateral Tax Treaties." He has opined that articles such as Books and Records are copyrighted articles and if they are sold, the user does not obtain the right to use any significant rights in the underlying copyright itself, which is what should determine the characterization of the revenue as sale proceeds rather than royalties. He has further opined that consideration relating to sale of software can amount to royalty only in limited circumstances.

172. For the above reasons, we are of the view that the payment by the cellular operator is not for any copyright in the software but is only for the software as such as a copyrighted article. It follows that the payment cannot be considered as royalty within the meaning of Explanation 2 below Section 9(1) of the Income-tax Act or Article Article of the DTAA with Sweden.
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184. In view of the foregoing discussion, we hold that the software supplied was a copyrighted article and not a copyright right, and the payment received by the Assessee in respect of the software cannot be considered as royalty either under the Income-tax Act or the DTAA.

17. Referring to the Commentary on the OECD Model Convention (dated 28.1.2003), which was considered to be of persuasive value, the Tribunal noticed that the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program, for example, where the transferee is granted limited rights to reproduce the program. This would be the common situation in transactions for the acquisition of a program copy. The rights transferred in these cases are specific to the nature of computer programs. They allow the user to copy the program, for example onto the user's computer hard drive or for archival purposes. 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 commercial income in accordance with Article 7 of DTAA.

18. The Tribunal further referred to the proposed amendments to the regulations of the Internal Revenue Service (IRS) in the USA not as binding but as having persuasive value and throwing light on the question i.e., the difference between a copyright right and a copyrighted article. The Tribunal noticed that the U.S. regulations distinguished between transfer of copyright rights and transfer of copyrighted articles based on the type of rights transferred to the transferee. Briefly stated, if the transferee acquires a copy of a computer programme but does not acquire any of the rights identified in certain sections (of the U.S. Regulations), the regulation classified the transaction as the transfer of a copyrighted article. If a transfer of a computer programme results in the transferee acquiring any one or more of the listed rights, it is a transfer of a copyright right. If a person acquires a copy of a computer programme but does not acquire any of the four listed copyright rights, he gets only a copyrighted article but no copyright. The four rights being:

> (i) The right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending.
>
> (ii) The right to prepare derivative computer programmes based upon the copyrighted computer programme
>
> (iii) The right to make a public performance of the computer programme.
>
> (iv) The right to publically display the computer programme.

19. The Tribunal further noticed that a copyrighted article has been defined in the regulation as including a copy of a computer programme from which the work can be perceived, reproduced or otherwise communicated either directly or with the aid of a machine or

device. The copy of the programme may be fixed in the magnetic medium of a floppy disc or in the main memory or hard drive of a computer or in any other medium.

20. The Tribunal has held rightly so that the question whether there was a transfer of a copyright right or only of a copyrighted article must be determined taking into account all the facts and circumstances of the case and the benefits and burden of ownership which have been transferred.

21. The appeal filed by the Revenue against the Judgment of the Special Bench of the ITAT was dismissed by the High Court of Delhi in the case of DIT V. M/S NOKIA NETWORKS OY (2012) 253 CTR (DEL) 417. The Bench approved the findings of the Special Bench of the Tribunal in the Motorola case (supra) that Copyright is distinct from the material object, copyrighted. It is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. He has an individual right of exclusive enjoyment. The transfer of the manuscript does not, of itself, serve to transfer the copyright therein. The transfer of the ownership of a physical thing in which copyright exists gives to the purchaser the right to do with it (the physical thing) whatever he pleases, except the right to make copies and issue them to the public. Just because one has the copyrighted article, it does not follow that one has also the copyright in it.

22. In the case of DIT V. ERICSSON A.B. (2012) 343 ITR 470 (DEL), one issue that the Delhi High Court was considering was whether the consideration for supply of software was payment by way of royalty and hence assessable both under Section 9(1)(vi) and the Double Taxation Avoidance Agreement between the Government of India and Sweden? The High Court relying on the judgment of the Supreme Court of India in TATA CONSULTANCY SERVICES VS.

STATE OF ANDHRA PRADESH, (2004) 271 ITR 401 (SC), held that software incorporated on a media would be goods and liable to sales tax. The High Court has held as under:

> 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.
> ……..
>
> 59.Be that as it may, in order to qualify as royalty payment, within the meaning of section 9(1)(vi) and particularly clause (v) of Explanation 2 thereto, 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. 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 present 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. 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.

23. The Delhi High Court in DIT Vs. ERICSSON A.B. [2012] 343 ITR 470 (Del.) further held that once it is held that payment in question is not royalty which would come within the mischief of clause (vi), the Explanation will have no application and that the question of applicability of the Explanation would arise only when payment is to be treated as "royalty" within the meaning of clause (vi) or "fee for technical services" as provided in clause (vii) of the Act.

24. In the case of DASSAULT SYSTEMS K. K., IN RE (2010) 322 ITR 125 (AAR) the Authority on Advance Ruling has held as under:

> Passing on a right to use and facilitating the use of a product for which the owner has a 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 trigger 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 a copyright. Where the purpose of the licence or the transaction is only to establish access to the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself has been transferred to any extent. It does not make any difference even if the computer programme passed on to the user is a highly specialized one. 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 definition clause in the Act as well as the Treaty. As observed earlier, those rights are incorporated in section 14. 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, in our view, amount to transfer of rights in relation to copyright or conferment of the right of using the copyright. However, where, for example, the owner of copyright over a literary work grants an exclusive licence to make out copies and distribute them within a specified territory, the grantee will practically step into the shoes of the owner/grantor and he enjoys the copyright to the extent of its grant to the exclusion of others. As the right attached to copyright is conveyed to such licencee, he has the authority to commercially deal with it. In case of infringement of copyright, he can maintain a suit to prevent it. Different

> considerations will arise if the grant is non-exclusive that too confined to the user purely for in-house or internal purpose. 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. That is what, in our view, follows from the language employed in the definition of "royalty" read with the provisions of the Copyright Act, viz., section 14 and other complementary provisions. We may refer to one more aspect here. In the definition of royalty under the Act, the phrase "including the granting of a licence" is found. That does not mean that even a non-exclusive licence permitting user for in house purpose would be covered by that expression. Any and every licence is not what is contemplated. It should take colour from the preceding expression "transfer of rights in respect of copyright". Apparently, grant of "licence" has been referred to in the definition to dispel the possible controversy a licence whatever be its nature, can be characterized as transfer.

25. The Authority on Advance Ruling in the case of DASSAULT SYSTEMS K. K., IN RE (SUPRA) negated the contention of the revenue that the right permitting the licensee to make a copy of the programme by loading the programme on the hard disk of the computer amounted to assignment of a right in the copyright in terms of section 14 of the Copyright Act as under:

> It has been contended on behalf of the Revenue that the right to reproduce the work in any material form including the storing of it in any medium by electronic means (vide section 14(a)(i) of the Copyright Act) must be deemed to have been conveyed to the end user. It is pointed out that a CD without right of reproduction on the hard disc is of no value to the end-user and such a right should necessarily be transferred to make it workable. It appears to us that the contention is based on a misunderstanding of the scope of right in sub-clause (i) of section 14(a). As stated in Copinger's treatise on Copyright, "the exclusive right to prevent copying or reproduction of a work is the most fundamental and historically oldest right of a copyright owner". We do not think that such a right has been passed on to the end-user by permitting him to download the computer programme and storing it in the computer for his own use. The copying/ reproduction or storage is only incidental to the facility extended to the customer to make use of the copyrighted product for his internal business purpose. As admitted by the Revenue's representative, that process is necessary to make the programme functional and to have

access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product. Apart from such incidental facility, the customer has no right to deal with the product just as the owner would be in a position to do. In so far as the licensed material reproduced or stored is confined to the four corners of its business establishment, that too on a non-exclusive basis, the right referred to in sub-clause (i) of section 14(a) would be wholly out of place. Otherwise, in respect of even off-the-shelf software available in the market, it can be very well said that the right of reproduction which is a facet of copyright vested with the owner is passed on to the customer. Such an inference leads to unintended and irrational results. We may in this context refer to section 52(aa) of the Copyright Act (extracted supra) which makes it clear that "the making of copies or adaptation" of a computer programme by the lawful possessor of a copy of such programme, from such copy (i) in order to utilize the computer program, for the purpose for which it was supplied or (ii) to make back up copies purely as a temporary protection against loss, destruction, or damage in order to utilize the computer programme for the purpose of which it was supplied" will not constitute infringement of copyright. Consequently, customization or adaptation, irrespective of the degree, will not constitute "infringement" as long as it is to ensure the utilization of the computer programme for the purpose for which it was supplied. Once there is no infringement, it is not possible to hold that there is transfer or licensing of "copyright" as defined in the Copyright Act and as understood in common law. This is because, as pointed out earlier, copyright is a negative right in the sense that it is a right prohibiting someone else to do an act, without authorization of the same, by the owner. It seems to us that reproduction and adaptation envisaged by section 14(a)(i) and (vi) can contextually mean only reproduction and adaptation for the purpose of commercial exploitation. Copyright being a negative right (in the sense explained in paragraph 9 supra), it would only be appropriate and proper to test it in terms of infringement. What has been excluded under section 52(aa) is not commercial exploitation, but only utilizing the copyrighted product for one's own use. The exclusion should be given due meaning and effect; otherwise, section 52(aa) will be practically redundant. In fact, as the law now stands, the owner need not necessarily grant licence for mere reproduction or adaptation of work for one's own use. Even without such licence, the buyer of product cannot be said to have infringed the owner's copyright. When the infringement is ruled out, it would be difficult to reach the conclusion that the buyer/licensee of product has acquired a copyright therein.

26. The Authority on Advance Ruling in the case of DASSAULT SYSTEMS K. K., IN RE (SUPRA) further approved the reasoning of the Special Bench of Income-tax Appellate Tribunal in MOTOROLA INC.(SUPRA)and noticed that the said decision has been followed in several decisions of the Income-tax Appellate Tribunal till date.

27. The Authority on Advance Ruling following the decision in the DASSAULT CASE (SUPRA) in the case of GEOQUEST SYSTEMS B.V.V. DIT (INTERNATIONAL TAXATION-I) [(2010)234CTR(AAR)73] held as under:

> 9. The revenue has sought to place reliance on the proviso to section 9(1)(vi) and sub-section (1A) of section 115A in order to contend that the Act contemplated charging of 'royalty' for authorization to use computer software as such and it is not necessary that the copyright therein should be specifically transferred. We are not impressed by this argument. The expression 'computer software' has been defined by Explanation 3 to section 9(1)(vi) for the purpose of the second proviso to the said clause. The computer software is defined to mean any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data. Under the second proviso the income by way of 'royalty' consisting of lump sum payment made by a resident for the transfer of all or any rights (including the grant of licence) in respect of the computer software by a non-resident manufacturer along with a computer based equipment under a scheme approved as per the 1986 Policy on computer software export, software development and training, is excluded from the purview of 'royalty' clause. It does not, however, mean that wherever computer software is transferred on outright sale basis or is leased or licensed, it would become royalty income. Whether or not the income is in the nature of royalty has to be judged with reference to the exhaustive definition in Explanation 2. In this context, sub-clause (v) of Explanation 2 which has been referred to by both sides become relevant. It is in the light of the language of that clause one has to see whether the income in question ought to be treated as 'royalty'. The transfer of rights envisaged by sub-clause (v) should be in respect of the 'copyright' among others. Mere transfer of computer software dehors any copyright associated with it does not fall within the ambit of the said clause (v). That is what has been held in the two rulings referred to earlier.

28. The Supreme Court of India in TATA CONSULTANCY CASE (SUPRA) was considering the question whether the sale of software was sale of goods and thus exigible to sales tax. The Supreme Court held that software may be intellectual property and contained on a medium was a marketable commodity and an object of trade and commerce. The Supreme Court of India held as under:

> "15. Sorabjee submitted that the question as to whether software is tangible or intangible property has been considered by the American Courts. He fairly pointed out that in America there is a difference of opinion amongst the various Courts. He submitted that, however, the majority of the Courts have held that a software is an intangible property. He showed to the Court a number of American Judgments, viz., the cases of Commerce Union Bank v. Tidwell 538 S.W.2d 405; State of Alabama v. Central Computer Services. INC 349 So. 2d 1156; The First National Bank of Fort Worth v. Bob Bullock 584 S.W.2d 548; First National Bank of Springfield v. Department of Revenue 421 NE2d 175; Compuserve, INC. v. Lindley 535 N.E. 2d 360 and Northeast Datacom, Inc., et al v. City of Wallingford 563 A2d 688. In these cases, it has been held that 'computer software' is tangible personal property. The reasoning for arriving at this conclusion is basically that the information contained in the software programs can be introduced into the user's computer by several different methods, namely, (a) it could be programmed manually by the originator of the program at the location of the user's computer, working from his own instructions or (b) it could be programmed by a remote programming terminal located miles away from the user's computer, with the input information being transmitted by telephone; or (c) more commonly the computer could be programmed by use of punch cards, magnetic tapes or discs, containing the program developed by the vendor. It has been noticed that usually the vendor will also provide manuals, services and consultation designed to instruct the user's employees in the installation and utilization of the supplied program. It has been held that even though the intellectual process is embodied in a tangible and physical manner, that is on the punch cards, magnetic tapes, etc. the logic or intelligence of the program remains intangible property. It is held that it is this intangible property right which is acquired when computer software is purchased or leased. It has been held that what is created and sold is information and the magnetic tapes or the discs are only the means of transmitting these intellectual creations from the originator to the user. It has been held that the same information could have been transmitted from the originator to the user by way of telephone

lines or fed directly into the user's computer by the originator of the programme and that as there would be no tax in those cases merely because the method of transmission is by means of a tape or a disc, it does not constitute purchase of tangible personal property and the same remains intangible personal property. It has been held that what the customer paid for is the intangible knowledge which cannot be subjected to the personal property tax. In these cases, difference is sought to be made between purchase of a book, music cassette/video or film and purchase of software on the following lines: "When one buys a video cassette recording, a book, sheet music or a musical recording, one acquires a limited right to use and enjoy the material's content. One does not acquire, however, all that the owner has to sell. These additional incidents of ownership include the right to produce and sell more copies, the right to change the underlying work, the right to license its use to other and the right to transfer the copyright itself. It is these incidents of the intellectual, intangible competent of the software property that Wallingford has impermissibly assessed as tangible property by linking these incorporeal incidents with the tangible medium in which the software is stored and transmitted."

16. It has been fairly brought to the attention of the Court that many other American Courts have taken a different view. Some of those cases are South Central Bell Telephone Co. v. Sidney J. Barthelemy 643 So.2d 1240; Comptroller of the Treasury v. Equitable Trust Company 464 A.2d 248; Chittenden Trust Co. v. Commissioner of Taxes 465 A.2d 1100; University Computing Company v. Commissioner of Revenue for the State of Tennessee 677 S.W.2d 445 and Hasbro Industries, INC. v. John H. Norberg, Tax Administrator 487 A.2d 124. In these cases, the Courts have held that when stored on magnetic tape, disc or computer chip, this software or set of instructions is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space. This machine readable language or code is the physical manifestation of the information in binary form. It has been noticed that at least three program copies exist in a software transaction: (i) an original, (ii) a duplicate, and(iii) the buyer's final copy on a memory device. It has been noticed that the program is developed in the seller's computer then the seller duplicates the program copy on software and transports the duplicates to the buyer's computer. The duplicate is read into the buyer's computer and copied on a memory device. It has been held that the software is not merely knowledge, but rather is knowledge recorded in a physical form having a physical existence, taking up space on a tape, disc or hard drive, making physical things happen and can be perceived by the senses. It has been held that the purchaser does not receive mere knowledge but receives an arrangement of matter

which makes his or her computer perform a desired function. It has been held that this arrangement of matter recorded on tangible medium constitutes a corporeal body. It has been held that a software recorded in physical form becomes inextricably intertwined with, or part and parcel of the corporeal object upon which it is recorded, be that a disk, tape, hard drive, or other device. It has been held that the fact that the information can be transferred and then physically recorded on another medium does not make computer software any different from any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape or books. It has been held that by sale of the software programme the incorporeal right to the software is not transferred. It is held that the incorporeal right to software is the copyright which remains with the originator. What is sold is a copy of the software. It is held that the original copyright version is not the one which operates the computer of the customer but the physical copy of that software which has been transferred to the buyer. It has been held that when one buys a copy of a copyrighted novel in a bookstore or recording of a copyrighted song in a record store, one only acquires ownership of that particular copy of the novel or song but not the intellectual property in the novel or song.

....

19. Thus this Court has held that the term "goods", for the purposes of sales tax, cannot be given a narrow meaning. It has been held that properties which are capable of being abstracted, consumed and used and/or transmitted, transferred, delivered, stored or possessed etc. are "goods" for the purposes of sales tax. The submission of Mr. Sorabjee that this authority is not of any assistance as a software is different from electricity and that software is intellectual incorporeal property whereas electricity is not, cannot be accepted. In India the test, to determine whether a property is "goods", for purposes of sales tax, is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed etc. Admittedly in the case of software, both canned and uncanned, all o f these are possible._

29. The Supreme Court of India in TATA CONSULTANCY CASE (SUPRA) referred to the Judgment of the Supreme Court in Associated Cement Companies Ltd. Vs Commissioner Of Customs (2001) 4 SCC 593 as under:

43. Similar would be the position in the case of a programme of any kind loaded on a disc or a floppy. For example in the case of music the value of a popular music cassette is several times more than the value of a blank cassette. However, if a pre recorded music cassette or a popular film or a musical score is imported into India duty will necessarily have to be charged on the value of the final product. In this behalf we may note that in State Bank of India v. Collector of Customs MANU/SC/0017/2000 : (2000) 1 SCC 727 the Bank had, under an agreement with the foreign company, imported a computer software and manuals, the total value of which was US Dollars 4,084,475. The Bank filed an application for refund of customs duty on the ground that the basic cost of software was US Dollars 401.047. While the rest of the amount of US Dollars 3,683,428 was payable only as a licence fee for its right to use the software for the Bank countrywide. The claim for the refund of the customs duty paid on the aforesaid amount of US Dollars 3,683,428 was not accepted by this Court as in its opinion, on a correct interpretation of Section 14 read with the Rules, duty was payable on the transaction value determined therein, and as per Rule 9 in determining the transaction value there has to be added to the price actually paid or payable for the imported goods, royalties and the licence fee for which the buyer is required to pay, directly or indirectly, as a condition of sale of goods to the extent that such royalties and fees are not included in the price actually paid or payable. This clearly goes to show that when technical material is supplied whether in the form of drawings or manuals the same are goods liable to customs duty on the transaction value in respect thereof.

44. It is a misconception to contend that what is being taxed is intellectual input. What is being taxed under the Customs Act read with the Customs Tariff Act and the Customs Valuation Rules is not the input alone but goods whose value has been enhanced by the said inputs. The final product at the time of import is either the magazine or the encyclopaedia or the engineering drawings as the case may be. There is no scope for splitting the engineering drawing or the encyclopaedia into intellectual input on the one hand and the paper on which it is scribed on the other. For example, paintings are also to be taxed. Valuable paintings are worth millions. A painting or a portrait may be specially commissioned or an article may be tailor made. This aspect is irrelevant since what is taxed is the final product as defined and it will be an absurdity to contend that the value for the purposes of duty ought to be the cost of the canvas and the oil paint even though the composite product, i.e., the painting, is worth millions.
……

48. The above view, in our view, appears to be logical and also in consonance with the Customs Act. Similarly in Advent Systems Ltd. v. Unisys Corporation 1925 F 2d 670 it was contended before the Court in the United States that software referred to in the agreement between the parties was a "product" and not a "good" but intellectual property outside the ambit of the Uniform Commercial Code. In the said Code, goods were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". Holding that computer software was a "good" the Court held as follows : "Computer programs are the product of an intellectual process, but once implanted in a medium they 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 it 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'."

30. The Supreme Court of India in Tata Consultancy Case (Supra) further held as under:

25. To be noted that this authority is directly dealing with the question in issue. Even though the definition of the term "goods" in the Customs Act is not as wide or exhaustive as the definition of the term "goods" in the said Act, it has still been held that the intellectual property when it is put on a media becomes goods.
....

27. 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.

31. S.B. Sinha J. in Tata Consultancy Case (Supra) concurring with the decision of the Majority referred to the Judgment in the case of South Central Bell Telephone Co. v. Sidney J. Barthelemny, et al. [643 So. 2d 1240 : 36 A.L.R. 5th 689], the Supreme Court of Louisiana held as under:

> 26. The court, however, noticed that the shift in the trend was not uniform. Having regard to the fact that the computer software became the knowledge and understanding and upon discussing the characteristics of computer software and classification thereof as tangible or intangible under Louisiana law, it was held:
>
> > "The software itself, i.e. the physical copy, is not merely a right or an idea to be comprehended by the understanding. The purchaser of computer software neither desires nor receives mere knowledge, but rather receives a certain arrangement of matter that will make his or her computer perform a desired function. This arrangement of matter, physically recorded on some tangible medium, constitutes a corporeal body. We agree with Bell and the court of appeal that the form of the delivery of the software-magnetic tape or electronic transfer via modem- is of no relevance. However, we disagree with Bell and the court of appeal that the essence or real object of the transaction was intangible property . That the software can be transferred to various

media i.e. from tape to disc, or tape to hard drive, or even that it can be transferred over the telephone lines, does not take away from the fact that the software was ultimately recorded and stored in physical form upon a physical object. See Crockett, supra, at 872-74; Shontz, at 168-70; Cowdrey, supra, at 188-90. As the court of appeal explained, and as Bell readily admits, the programs cannot be utilized by Bell until they have been recorded into the memory of the electronic telephone switch. 93-1072, at p. 6, 631 So.2d at 1342. The essence of the transaction was not merely to obtain the intangible "knowledge" or "information", but rather, was to obtain recorded knowledge stored in some sort of physical form that Bell's computers could use. Recorded as such, the software is not merely an incorporeal idea to be comprehended, and would be of no use if it were. Rather, the software is given physical existence to make certain desired physical things happen. One cannot escape the fact that software, recorded in physical form, becomes inextricably intertwined with, or part and parcel of the corporeal object upon which it is recorded , be that a disc, tape, hard drive, or other device. Crockett, supra, at 871072; Cowdrey, Supre, at 188-90. That the information can be transferred and then physically recorded on another medium is of no moment, and does not make computer software any different than any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape, or books.

" It was further opined :

"It is now common knowledge that books, music, and even movies or other audio/visual combinations can be copied from one medium to another. They are also all available on computer in such forms as floppy disc, tape, and CD-ROM. Such movies, books, music, etc .can all be delivered by and/or copied from one medium to another, including electrical impulses with the use of a modem. Assuming there is sufficient memory space available in the computer hard disc drive such movies, books, music, etc .can also be recorded into the permanent memory of the computer such as was done with the software in this case. 93-1072, at p. 4, 5. 631 So.2d at 1346-47 (dissenting opinion). See also Shontz. Supra, at 168-170; Harris, supra, at 187. That the information, knowledge, story, or idea, physically manifested in recorded form, can be transferred from one medium to 15 another does not affect the nature of that physical manifestation as corporeal, or tangible. Shontz, supra, at 168-170. Likewise, that the software can be transferred from 1248

> one type of physical recordation, e.g., tape, to another type, e.g., disk or hard drive, does not alter the nature of the software, Shontz, supra, at 168-170; it still has corporeal qualities and is inextricably intertwined with a corporeal object. The software must be stored in physical form on some tangible object somewhere.........”

> 27. Reversing the findings of the court below that the computer software constitutes intellectual property, it was opined :
>
> "In sum, once the "information" or "knowledge" is transformed into physical existence and recorded in physical form, it is corporeal property. The physical recordation of this software is not an incorporeal right to be comprehended. therefore we hold that the switching system software and the data processing software involved here is tangible personal property and thus is taxable by the City of New Orleans."

32. The Supreme Court in Tata Consultancy Case (Supra) have thus laid down that Computer programs are the product of an intellectual process, but once implanted in a medium they are widely distributed to computer owners. 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.

33. The Supreme Court has further held that 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". There is 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. The software itself, i.e. the physical copy, is not merely a right or an idea to be comprehended by the understanding.

34. It has been further held that the purchaser of computer software neither desires nor receives mere knowledge, but rather receives a certain arrangement of matter that will make his or her computer perform a desired function. This arrangement of matter, physically recorded on some tangible medium, constitutes a corporeal body. The form of the delivery of the software-magnetic tape or electronic transfer via modem- is of no relevance. That the software can be transferred to various media i.e., from tape to disc, or tape to hard drive, or even that it can be transferred over the telephone lines, does not take away from the fact that the software was ultimately recorded and stored in physical form upon a physical object. Recorded as such, the software is not merely an incorporeal idea to be comprehended, and would be of no use if it were. Rather, the software is given physical existence to make certain desired physical things happen. One cannot escape the fact that software, recorded in physical form, becomes inextricably intertwined with, or part and parcel of the corporeal object upon which it is recorded , be that a disc, tape, hard drive, or other device. That the information can be transferred and then physically recorded on another medium is of no moment, and does not make computer software any different than any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape, or books. It is now common knowledge that books, music, and even movies or other audio/visual combinations can be copied from one medium to another. They are also all available on computer insuch forms as floppy disc, tape, and CD-ROM. Such movies, books, music, etc. can all be delivered by and/or copied from one medium to another, including electrical

impulses with the use of a modem. Assuming there is sufficient memory space available in the computer hard disc drive such movies, books, music, etc. can also be recorded into the permanent memory of the computer. That the information, knowledge, story, or idea, physically manifested in recorded form, can be transferred from one medium to another does not affect the nature of that physical manifestation as corporeal, or tangible. Likewise, that the software can be transferred from one type of physical recordation, e.g., tape, to another type, e.g., disk or hard drive, does not alter the nature of the software, it still has corporeal qualities and is inextricably intertwined with a corporeal object. The software must be stored in physical form on some tangible object somewhere. In sum, once the "information" or "knowledge" is transformed into physical existence and recorded in physical form, it is corporeal property. The physical recordation of this software is not an incorporeal right to be comprehended.

35. To further elucidate the nature of the transaction in the case of the Assessee it is necessary to examine some of the clauses of the Licensing software agreement entered into by the Assessee with its customers:

36. Clause No. 2 of the Agreement for sale and Assignment of Intellectual Property Technology Transfer is mentioned below:

> “The Seller irrevocably sells and transfers to Buyer all rights, title and interest (including but not limited to, all registration rights, all rights to prepare derivative works, all goodwill and all other rights), in and to the intellectual Property and assigns to the Buyer exclusively throughout the world all right, title and interest (choate or inchoate) in and the Assessee has entered into separate supplementary agreements for acquiring the intellectual property/technical transfer of rights, title, and interest, in and to the intellectual property and assigns to the Buyer throughout the world all right, title and interest (choate or inchoate) in (i) subject matter referred to in Schedule A specification oriented off shelf Computer Software programme.

As per the clause No. 1 of the supplementary assignment agreement with the Intra Asia Trading Pte. Ltd. the sale and assignment of intellectual property/technology transfer: The Seller Sells and transfers to Buyer all rights, title, and interest, in and to the Intellectual Property and assigns to the Buyer throughout the world all right, title and interest (choate or inchoate) in the subject matter referred to in Schedule A specification oriented off shelf Computer Software programme. As per the clause 2 consideration : in consideration for the sale of rights and source code assignment set for the in Articles 2, Buyer shall pay Seller USD 40,000 towards intellectual property Right/Rights and source code which includes in total purchase value of USD 1982454

As per Clause No. 3 the folio wings clauses are mentioned regarding the representations and warranties which states that all the rights will be subject to taxation as intellectual property.

(a) Seller has the right, power and authority to enter into this agreement;

(b) Seller is the exclusive owners of all right, title and interest in the Technology free of any security interest, charge or encumbrance;

(c) Seller warrants that all documents, computer records, disks and other materials of any nature of kind containing the Technology or any portion thereof have been turned over to Buyer, and that Seller will not retain the Technology, or any portion thereof, in any form whatsoever after the closing of the within transactions except as specifically permitted hereunder;

(d) The intellectual Property does not infringe the rights of any person or entity;

(e) There are not claims, pending or threatened, with respect of Seller's right in the intellectual Property;

(f) This Agreement is valid, binding and enforceable in accordance with its terms of this agreement.

1. Seller is not subject to any agreement, judgment or order inconsistent with the terms of this Agreement.

2. The Seller is not restrained from Selling and/assigning the intellectual property rights by any statutory authority in the country of its incorporation.

As per Clause 4 of the supplementary agreement Further assurances, Moral rights, Competition, Marketing:

Seller agrees to assist the Buyer in every legal way to evidence, record and perfect the section 1 assignment and to apply for and obtain recordation of and from time to time enforce, maintain, and defend the assigned rights. If the Buyer is unable for any reason whatsoever to secure the Seller's signature to any document it is entitled to under this section 3, Seller hereby irrevocably designates and appoints the Buyer and its duly authorized officers and agents, as his agents and attorneys-in-fact with full power of substitution to act for and on his behalf and instead of Seller, to execute and file any such document or documents and to do all other lawfully permitted acts to further the purposes of the foregoing with the same legal force and effect as if executed by Seller.

To the extent allowed by Law, Section 1 includes all rights of paternity, integrity, disclosure and withdrawal and any other rights that may be known as or referred to as “moral rights.” artist's rights, “droit moral" or the like (collectively “Moral Right"). To the extent Seller retains any such Moral Rights under applicable law. Seller hereby ratifies and consents to, and provides all necessary ratification and consents to, any action that may be taken with respect to such Moral Rights by or authorized by Buyer, Seller agrees not to assert any Moral Rights with respect thereto. Seller will confirm any such ratifications, consents and agreements from time to time as requested by Buyer.

As per the clause No. 7 Entire Agreement : This Agreement, contains the entire understanding and agreement between the parties hereto with respect to its subject matter and supersedes any prior or contemporaneous written or oral agreements, representations or warranties between them respecting the subject matter thereof".

37. Further, the Licensing Agreement shows that the license is non-exclusive, non-transferable and the software has to be used in accordance with the Agreement. The buyer, being assessee, purchased all rights, title and interest in and to the intellectual property and seller assigned to the assessee throughout the world all right, title and interest in relation to the source code for the smart card operating system mentioned in the Schedule A of the agreement.

the assessee acquired a readymade of – the shelf computer programme to be used in their business and no right was granted to the assessee to utilize the copy right of the programme. The assessee has purchased only copy of the copyrighted article i.e., a computer programme which was called software and, therefore, consideration cannot be treated as royalty. In other words, assessee is permitted to make only 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 copyright and other proprietary notices. Copies of the Software are the exclusive property of Intra Asia Trading (P) Ltd. 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 Intra Asia Trading (P) Ltd. Without the consent of the Seller 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. The Licensee is further restricted from making copies, decompile, disassemble or reverse-engineer the Software without Intra Asia Trading (P) Ltd.'s written consent. The Software contains a mechanism which Intra Asia Trading (P) Ltd. 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 Intra Asia Trading (P) Ltd..

38. The Agreements show that the license is non-exclusive, non-transferable and the software has to be used in accordance with the agreement. It is also stipulated that the copy so made shall include Intra Asia Trading (P) Ltd's copyright and other proprietary notices. All copies of the Software are the exclusive property of Intra Asia Trading (P) Ltd.. 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 Intra Asia Trading (P) Ltd. Licence Schedule.

39. 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.

40. 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.

41. 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 in his favour.

42. The license granted to the licensee permitting him to use the programme for its business purpose is only incidental to the facility extended to the licensee to make use of the copyrighted product for its internal business purpose. The said process is necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said paragraph because it is only integral to the use of copyrighted product. Apart from such incidental facility, the licensee has no right to deal with the product just as the owner would be in a position to do.

43. There is no transfer of any right in respect of copyright by the Assessee and it is a case of mere transfer of a copyrighted article.

The payment is for a copyrighted article and represents the purchase price of an article and cannot be considered as royalty either under the Income Tax Act or under the DTAA.

44. The licensees are not allowed to exploit the computer software commercially, they have acquired under licence agreement, only the copy righted software which by itself is an article and they have not acquired any copyright in the software. In the case of the Assessee company, the licensee to whom the Assessee company has sold/licensed the software were allowed to make only one copy of the software and associated support information for backup purposes with a condition that such copyright shall include Intra Asia Trading (P) Ltd. copyright and all copies of the software shall be exclusive properties of Intra Asia Trading (P) Ltd. Licensee was allowed to use the software only for its own business as specifically identified and was not permitted to loan/rent/sale/sub-licence or transfer the copy of software to any third party without the consent of Intra Asia Trading (P) Ltd.

45. The licensee has been prohibited from copying, de-compiling, de-assembling, or reverse engineering the software without the written consent of Intra Asia Trading (P) Ltd. The licence agreement between the Assessee company and its customers stipulates that all copyrights and intellectual property rights in the software and copies made by the licensee were owned by Intra Asia Trading (P) Ltd. and only Intra Asia Trading (P) Ltd. has the power to grant licence rights for use of the software. The licence agreement stipulates that upon termination of the agreement for any reason, the licencee shall return the software including supporting information and licence authorization device to Intra Asia Trading (P) Ltd..

46. The incorporeal right to the software i.e. copyright remains with the owner and the same was not transferred by the Assessee. The right to use a copyright in a programme is totally different from the

right to use a programme embedded in a software and the payment made for the same cannot be said to be received as consideration for the use of or right to use of any copyright to bring it within the definition of royalty as given in the DTAA. What the licensee has acquired is only a copy of the copyright article whereas the copyright remains with the owner and the Licensees have acquired a computer programme for being used in their business and no right is granted to them to utilize the copyright of a computer programme and thus the payment for the same is not in the nature of royalty.

47. We have not examined the effect of the subsequent amendment to section 9 (1)(vi) of the Act and also whether the amount received for use of software would be royalty in terms thereof for the reason that the Assessee is covered by the DTAA, the provisions of which are more beneficial. The amount received by the Assessee under the licence agreement for allowing the use of the software is not royalty under the DTAA.

48. What is transferred is neither the copyright in the software nor the use of the copyright in the software, but what is transferred is the right to use the copyrighted material or article which is clearly distinct from the rights in a copyright. The right that is transferred is not a right to use the copyright but is only limited to the right to use the copyrighted material and the same does not give rise to any royalty income and would be business income.

49. In view of elaborate discussion and in the light of the judgment of the Hon'ble Delhi High court in the case of DIT Vs. Infrasoft Ltd. (supra), on which reliance placed by the learned AR, in the present case, the assessee has acquired a readymade off – the shelf computer programme to be used in their business and no right was granted to the assessee to utilize the copy right of the programme and, therefore, consideration cannot be treated as royalty. As held by

the CIT(A), the payments made by the assessee company cannot be held as 'royalties' coming into the ambit of Article 12 of DTAA or 'fee for technical services' u/s 9(1)(vii) of the IT Act and accordingly no tax need to be deducted u/s 195 of the IT Act. We, therefore, uphold the order of the CIT(A) on this count and dismiss the grounds raised by the revenue in this regard.

50. In the result, appeal of the revenue is dismissed.

Pronounced in the open court on 27/01/2014.

Sd/-	Sd/-
(ASHA VIJAYARAGHAVAN)	(CHANDRA POOJARI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Hyderabad, dated 27/01/2014.
kv

Copy forwarded to:

1. ADIT (IT), Unit-I, 6th Floor, 'C' Block, IT Towers, AC Guards, Hyderabad.
2. M/s Bartronics India Ltd., 8-2-120/77/48, Besides TDP Office, Road No. 2, Banjara Hills, Hyderabad.
3. CIT(A)-VI, Hyderabad
4. DIT(E), Hyderabad
5. The DR, ITAT, Hyderabad

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9	Date of Dispatch of order			