IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "K", MUMBAI

BEFORE SHRI D. KARUNAKARA RAO, ACCOUNTANT MEMBER AND
SHRI SANJAY GARG, JUDICIAL MEMBER

ITA No.7779/M/2011
Assessment Year: 2007-08

M/s. Capgemini Business Services (India) Ltd., Gate No.4, Unit 19, Godrej Industries Complex, Eastern Express Highway, Vikhroli (East), Mumbai – 400 093 **PAN: AABCI 1046A**	Vs.	Assistant Commissioner of Income Tax-1(2), Mumbai
(Appellant)		(Respondent)

Present for:
Assessee by : Shri M.M. Golvala, A.R.
Revenue by : Shri A.A. Khan, D.R.

Date of Hearing : 04.02.2016
Date of Pronouncement : 29.02.2016

O R D E R

Per Sanjay Garg, Judicial Member:

The present appeal has been preferred by the assessee against the order dated 08.08.2011 of the Dispute Resolution Panel (hereinafter referred to as the DRP) relevant to assessment year 2007-08.

2. The brief facts of the case are that the assessee namely 'Capgemini Business Services (India) Limited' [Formerly known as 'Unilever India Shared Services Limited'] (hereinafter referred to as the assessee or assessee company) for a part of A.Y 2007-08 was a subsidiary of Hindustan Unilever Limited (HUL), which is in turn a subsidiary of Unilever Plc. CBSIL, has its registered office in Mumbai and corporate office in Bangalore. Cape Gemini SA., France acquired 51% shareholding in CBSIL from HUL on 11 October 2006 (during the relevant AY 2007-08). Pursuant to the acquisition, the name

of the company has been changed from 'Unilever India Shared Services Limited' to 'Capgemini Business Services (India) Limited' with effect from 14 May 2007. During A.Y 2007-08, the assessee had primarily provided business process management services in the areas of finance accounts, operational control assessment, administration of foreign exchange, one off consultancy projects and competitors' intellectual study to Unilever group companies. The services rendered by the assessee have been in the nature of 'Information Technology Enabled Services' (ITES) / 'Back Office Support Services'. Considering that the Unilever Group had an indirect equity stake in excess of 26% in the assessee for the period from 1 April 2006 to 11 October 2006, the transactions between the assessee and Unilever group entities came under the purview of 'Indian Transfer Pricing (TP) Regulations'.

The assessee had selected the Transactional Net Margin Method (TNMM) as the most appropriate method to determine the arm's length price for the provision of ITES to group entities and had selected comparable companies rendering ITES for determination of arm's length price. Based on the analysis carried out by the assessee, the international transactions were determined as meeting with the arm's length price. The assessee's case was referred to the Transfer Pricing Officer (TPO) for AY 2007-08. The TPO proposed an adjustment to the transfer prices with respect to the provision of ITES to the tune of Rs.33,070,534/-. The Assessing Officer (hereinafter referred to as the AO) relied on the TPOs Order and issued a draft assessment order under Section 144C(1) of the Act proposing the above TP adjustment. The assessee filed objections against the draft assessment order before the DRP. However, the DRP rejected the assessee's objections not only in relation to transfer pricing adjustments but also in relation to disallowances proposed by the AO in relation to club entrance fee, credit of 'branch profit tax' paid by the assessee in USA and the expenditure incurred towards purchase of 'software'. Being aggrieved by the order of the Ld. DRP, the assessee has come in appeal before us with the following grounds of appeal:

"Ground No.1 - Transfer Pricing ('TP') adjustment of Rs.3,30,70,534

On the facts, in law and in the circumstances of the present case, the learned Additional Commissioner of Income-tax 1(2) (hereinafter referred as 'AO') and the Dispute Resolution Panel ('DRP') erred in concluding the assessment by upholding the action of the Additional Commissioner of Income-tax Transfer Pricing Officer - 1(2) (hereinafter referred as 'TPO') in determining the arm's length price of the international transaction of business process management services rendered to Associated Enterprises ('AEs') at Rs. 50,99,80,530 instead of Rs.47,69,09,996 as determined by Capgemini Business Services (India) Limited ('the Appellant') by:

a. considering the Appellant's transactions with overseas Unilever group entities, post transfer of the Appellant's shareholding to Capgemini Group from Unilever Group on 11 October 2006, as international transaction, having failed to appreciate that Unilever Plc's shareholding (indirect) in Appellant post 11 October 2006 fell below the 26% limit under Section 92A(2)(a) of the Act for the purpose of constituting AE;

b. disregarding the internal comparability analysis between the Appellant's international transactions with overseas Unilever group entities for the period:

- prior to the acquisition of Appellant's shareholding by Capgemini Group; and
- post such acquisition.

c. disregarding the Appellant's contemporaneous TP documentation and conducting his own comparability analysis which is not in accordance with contemporaneous documentation requirement under Indian TP regulations, having failed to appreciate that in the case under consideration, none of the conditions set out in Section 920(3) of the Act are satisfied;

d. selecting companies that are not comparable to the Appellant vis-a-vis its AEs, for the determination of the arm's length price;

e. using current year's financial data (i.e. Financial Year 2006-07) for the comparable companies for benchmarking the Appellant's international transactions pertaining to business process management services rendered to AEs;

f. not granting a working capital adjustment to the Appellant to account for the differences in the working capital cycle of the comparables vis-à-vis the Appellant; and

g. denying the (+/-) 5% range benefit available under proviso to Section 92C(2) of the Act.

The Appellant prays that the book value of the international transaction be held to be the arm's length price and accordingly, the AO be directed to delete the adjustment of Rs. 3,30,70,534.

2. Club entrance fees

On the facts, in law and in the circumstances of the present case, the AO erred in disallowing expense of Rs. 550,000 incurred towards club entrance fees.

The Appellant prays that the sum of Rs. 550,000 be allowed as business expense and the additions made by the AO be deleted.

3. Tax credit in India for Branch Profit Tax paid by the Appellant in USA

On the facts, in law and in the circumstances of the present case, the AO erred in not allowing tax credit of Branch Profit Tax of US$ 31,310 (equivalent to Rs.1,408,950) paid in USA.

The Appellant prays that the Branch Profit Tax of US$ 31,310 (equivalent to Rs. 1,408.950) paid in USA be allowed as tax credit while determining the Indian income-tax liability.

4. Payment towards purchase of software

On the facts, in law and in the circumstances of the present case, the AO has erred in disallowing expenditure of Rs. 953,437, incurred for purchase of 'off the shelf' software from QAD Singapore Pte Ltd., Singapore, under Section 40(a)(i) of the Act alleging that the said expenditure is subject to deduction of tax at source under Section 195 of the Act.

The Appellant prays that the expenditure towards purchase of 'off the shelf' software be allowed.

5. On the facts, in law and in the circumstances of the present case, the learned AO erred in levying interest under Section 234B and 234C of the Act.

The Appellant craves leave to add, alter, amend or withdraw all or any of the Grounds of Appeal (hereinafter referred to as the AO) and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing."

Ground No.1

3. Though, the assessee has raised various points and issues vide different sub grounds taken in ground No.1, however, the Ld. A.R. of the assessee, at the outset, has submitted that so far as the transfer pricing adjustments are concerned, the assessee had provided 12 comparables whereas the TPO accepted only 4 out of those. The TPO himself added 25 comparables for

arriving at arm's length price for determining the transfer pricing adjustments. The TPO had accepted the analysis of the assessee using the TNMM as most appropriated method for determination of ALP of international transactions whereby the operating margin of the assessee was compared vis-à-vis its transactions with Unilever group entities during the period prior to 11.10.06 with its operating margin from transactions with Unilever entities in post 11.10.06 period. This internal comparison was done by the TPO as the functions' profile of the assessee in pre and post scenarios had remained the same. The TPO also carried out external comparability analysis. According to the analysis report given by the assessee the ratio of OP/OC (Operating profit/operating cost) was given at 19.91% whereas as per the comparables taken by the TPO, the OP/OC ratio came to 28.23%. The short contention of the Ld. A.R. before us has been that the assessee otherwise will be satisfied if the comparables introduced by the AO are taken for analysis except the two i.e. Mold-Tek Technologies Ltd. (SCG) mentioned at Sl. No.20 and in case of Vishal International Technology Ltd. mentioned at Sl. No.24 of the comparables taken by the TPO in his order. He has submitted that if the above two comparables are excluded, the arm's length price so arrived after taking the other comparables of the TPO will be in the range of ± 5% of the price declared by the assessee.

The Ld. A.R. of the assessee while inviting our attention to the business activity of Mold-Tek Technologies Ltd. has pointed out that the said company has been in a totally different activity. He, in this respect, has invited our attention to page 247 & page 251 of the paper book, which are the part of the director's report for the year ended 31.03.07 of Mold-Tek Technologies Ltd., wherein it has been provided that during the year, the IT division of the said company commenced engineering services to high rise buildings for clients in US and Canada which offered excellent growth prospects. The company had two divisions, one is plastic division and the other is KPO division. KPO division deals with IT enabled services providing services in relation to designing and detailing of the buildings apart from other activities. The Ld. A.R. has further invited our attention to the Special Bench decision of the Tribunal in the case of "Maersk Global Centres (India) (P.) Ltd. vs. ACIT" (2014) 31 ITR(Tri.-1) (Mumbai-SB). The assessee company in that case was engaged in almost similar activities as that of the assessee before us, i.e. services relating to transaction, processing data entry, reconciliation of statements and other similar support services. In the said case, the AO had taken the said company Mold-Tek Technologies Ltd. as comparable, however the Special Bench of the Tribunal in para 81 of the order has observed that from the annual report of the said company for the financial year 2007-08, it revealed that the said company was providing structural engineering KPO services and its business activity was entirely different from that of the assessee's BPO/KPO services provided by the assessee in relation to back office support, data processing and analysis etc. The relevant observations of the Special Bench of the Tribunal for the sake of convenience are reproduced as under:

> "81. In so far as the case of Mold-Tek Technologies Ltd. is concerned, it is observed from the annual report of the said company for the financial year 2007-08 placed at page 139 to 151 of the paper book that the said company was pioneer in structural engineering KPO services and its entire business comprised of providing only structural engineering services to various clients. Further information of Mold-Tek Technologies Ltd. available on their Website is furnished in the form of printout at page 158 to 165 of the paper book and a perusal of the same shows that it is a leading provider of engineering and design services with specialization in civil, structural and mechanical engineering services. It is stated to have a strong team of skilled resources with world class resources and skill sets. It is also stated to have consistently helped the clients to cut down design and development costs of civil, structural, mechanical and plant design by 30-40% and delivered technologically superior outputs to match and exceed expectations. It is claimed to have in-house software development team, quality control training and trouble shooting facilities. M/s Mold-Tek is also rendering web design and development services with experience in turning them into an effective graphic design representation and creating dynamic and graphic rich web applications from IT specs, design prints etc. Keeping in view this information available in the annual report of Mold-Tek as well on its website, we are of the view that the said company is mainly involved in providing high-end services to its clients involving higher special knowledge and domain expertise in the field and the same cannot be taken as comparable to the assessee company which is mainly involved in providing

low-end services."

4. A perusal of the record reveals that the business activity of the Mold-Tek Technologies Ltd. and that of the assessee are entirely different. The scope of profit and margins owing to the different nature of services offered by the assessee and Mold-Tek Technologies Ltd. may also be different. The Mold-Tek Technologies Ltd. is providing high end services in structural engineering. At this stage, the Ld. A.R. has invited our attention to page 251 of the paper book to contend that the Mold-Tek Technologies Ltd. is also engaged in providing Healthcare Billing Services. May it be so, the point raised by the Ld. AR is that the nature of services provided by Mold-Tek Technologies Ltd. are entirely different from that of the assessee. The assessee's services are mainly relating to data analysis and back up office support services which do not require much involvement of high skilled knowledge process and expense whereas, in case of Mold-Tek Technologies Ltd. the nature of services, itself, reveals that the same involved high-tech skills, domain knowledge and experience of highly skilled and professionals/ persons and that the profit margin in such type of skilled services will be higher.

We agree with the finding of the Special Bench of the Tribunal when we compare the case of the assessee with that of Mold-Tek Technologies Ltd. that the Mold-Tek cannot be taken as a comparable to determine arm's length price in case of transactions of assessee with its associate enterprises.

The second objection pressed by the assessee is in relation to Vishal International Technology Ltd. pleading that the same cannot be considered as a comparable for the purpose of calculating the bench mark operating profit margin on the ground that the business model of the said company was different. It was contended that Vishal International Technology Ltd. was engaged in the services of data analytics and providing data services solutions. However, the employees' salary cost of Vishal International Technology Ltd. was relatively very low as compared to that of the assessee. The Vishal

International Technology Ltd. had outsourced significant parts of operations and did not have so much employees' salary cost as was in the case of the assessee and therefore the business model of the Vishal International Technology Ltd. was different. The Ld. A.R. has relied in this respect to the decision of the Hon'ble Delhi High Court in the case of "Rampgreen Solutions Pvt. Ltd. vs. CIT" in ITA No.102 of 2015 decided vide order dated 10.08.15. The business model of the Vishal International Technology Ltd. being different on the ground that it was indulged in out sourcing of its operations has not only been considered by the special bench of the Tribunal but also by the Hon'ble Delhi High Court in the case of "Rampgreen Solutions Pvt. Ltd." (supra).

5. Considering the above facts on the file and the submissions made by the Ld. Representatives of the parties, in our view, the Mold-Tek Technologies Ltd. and Vishal International Technology Ltd. cannot be taken as comparables.

6. We, accordingly, direct the AO to exclude Vishal International Technology Ltd. and Mold-Tek Technologies Ltd. while determining the arm's length price of the assessee relating to the transactions with its AEs. This issue is decided accordingly.

<u>Ground No.2</u>

7. Ground No.2 is relating to club entrance fees. The AO disallowed the expenses of Rs.5,50,000/- incurred towards club entrance fees on the ground that the assessee has made a claim that the special membership would help in building better relationship with clients without submitting any cogent evidence in this respect. Before us, the Ld. A.R. of the assessee has submitted that the same was a corporate membership and the company had nominated two of its employees i.e. CEO and Chief Engineer Operations for availing the membership facilities. He has further invited our attention to the full bench decision of the Hon'ble Punjab & Haryana High Court in the case of "CIT vs. Groz Beckert Asia Ltd." reported as (2013) 351 ITR 196 P&H (FB), wherein,

the Hon'ble High Court has held that no capital asset is created or comes into existence on account of obtaining corporate membership. The corporate membership obtained was for a limited period and it was obtained for running the business with a view to produce profit and the said corporate membership fee paid to the club was to be treated as revenue expenditure. Relying on the said the Full Bench decision of the Hon'ble Punjab & Haryana High Court, this ground is decided in favour of the assessee.

Ground No.3

8. Vide ground No.3, the assessee has agitated the action of the lower authorities in not allowing tax credit of branch profit tax paid in USA. The lower authorities, in this respect, have relied upon Article 2 of the Indo US DTAA (Double Taxation Avoidance Agreement), wherein, the taxes covered under the treaty in the United States *inter alia* are the federal income taxes imposed by the US 'Internal Revenue Code' but excluding the 'accumulated earning tax', 'the personal holding tax' and 'social security taxes' etc. The contention of the lower authorities is that the 'branch holding tax' is akin to the 'accumulated earning tax' which has been specifically excluded from the taxes covered under the DTAA. The Ld. A.R. of the assessee, however, brought our attention to page 1161 of the paper book which is the copy of section 531 of the US 'Internal Revenue Code' which is relating to the imposition of accumulated earning tax. He has further invited our attention to section 884 of the 'Internal Revenue Code' which deals with the branch profit tax. He, in this respect, has argued that the 'accumulated earning tax' and the 'branch profit tax' are the different taxes which have been dealt by different sections. Section 531 of the Internal Revenue Code deals with imposition of 'accumulated earning tax,' whereas, section 884 deals with 'branch profit tax'. The Ld. A.R. has further invited our attention to page 1167 of the paper book which is the "Official Technical Explanation of the Convention and Protocol between the US and India". This technical explanation is an official guide to

the convention/DTAA. The scope of Article II relating to "Taxes Covered" has been explained in the said guide/technical explanation. It has been specifically provided that the taxes covered in the case of US, as indicated in paragraph 1(a) of Article II, are the Federal income taxes imposed by the Code, together with the excise tax imposed on insurance premiums paid to foreign insurers (Code section 4371). The Article specifies that the Convention does not apply to the accumulated earning tax (Code section 531), the personal holding company tax (Code section 541) or the social security taxes (Code sections 1401, 3101 and 3111). State and local taxes in the United States are also not covered by the Convention. A perusal of the Article II of the 'DTAA' read with the 'technical explanation to the convention' reveals beyond doubt that the taxes which have been excluded from the purview of the DTAA have been specifically mentioned therein. Further, as observed above, the accumulated earning tax, which has been provided under section 531 of the Internal Revenue Code of the US, is different from 'branch profit tax' which is dealt with under separate section 884. The 'section 884' dealing with branch profit tax has not been specifically excluded from the DTAA and thus being a part of the Internal Revenue Code is covered by the US treaty. This issue is accordingly decided in favour of the assessee.

Ground No.4

9. Ground No.4 is in relation to disallowance of expenditure of Rs.9,53,437/- incurred for purchase of "off the shelf" software from 'QAD Singapore Pvt. Ltd.' under section 40(a)(i) of the Act on the ground that the said expenditure was subject to deduction of tax at source under section 195 of the Act. The AO noticed that the assessee had incurred expenses in foreign currency for the purchase of software from QAD Singapore Pvt. Ltd. The case of the assessee has been that it had not purchased any copyright in the software rather, it had purchased only a copyrighted article named as 'MFG Pro Software.' The AO, however, observed that the assessee had purchased the

right to use the software and the software is used for the business purpose in India. He, therefore, held that the same was liable for deduction of tax at source under section 195 of the Act in view of the provisions of section 9 of the Income Tax Act, wherein it has been provided that the income on account of consideration paid for royalty is to be deemed to have accrued in India.

10. Before the DRP, the assessee adduced evidence in the form of invoice and other documents/material in respect of the software purchased to prove that the said software has been standard software and that the payment made by the assessee for the said software was a onetime payment and not a recurring payment for use of software. It was also explained by the assessee that what it had purchased was a 'copyrighted article' and not the 'copyright,' itself, so as to classify it as royalty or fees for technical services.
In para 7.3 of the impugned order, the DRP, after perusal of the documents submitted by the assessee, has held that the software purchased was a one "off the shelf" product. However, the DRP further observed that the software was not sold but a license was given to the assessee to use it in a particular manner in consideration of the license fee. Even after obtaining a copy of the software, the assessee required permission to use the software by way of activation on a certified machine. Therefore, payment made by the end user was towards license to use copyright in software and not for sale of software. The DRP, therefore, held that the license to use the software would fall under the purview of royalty. Being aggrieved by the above finding of the DRP, the assessee has come in appeal before us.

11. We have heard the rival contentions and have also gone through the records. The Ld. A.R. of the assessee has contended that 'MFG Pro Software' purchased by the assessee is an accounting software and is available off the shelf. QAD Singapore Pvt. Ltd. supplied the said software to the assessee company outside India on a computer disk with free on board basis and further that the said entity does not have a permanent establishment in India. He,

therefore, has contended that the said disk purchased by the assessee would fall in the definition of 'goods' as defined in the 'Sale of Goods Act' and the consideration paid is the sale price of the goods and not the royalty and hence the assessee was not liable to deduct TDS on the payment for the purchase of goods from the foreign company as the same was business income in the hands of the recipient and not the royalty. The Ld. A.R. of the assessee, in this respect has relied upon the decision of the Hon'ble Delhi High Court in the case of "DIT vs. Infrasoft Ltd." (2013) 39 taxmann.com 88 (Del.) and further on another decision of the Hon'ble Delhi High Court in the case of "DIT vs. Ericson A.B." (2012) 343 ITR 470.

12. On the other hand, the Ld. D.R., relying upon the decisions of the co-ordinate bench of this Tribunal in the case of "Reliance Infocom Ltd." and in specific relying on para 29, 35 & 36 of the said decision, has contended that the software purchased by the assessee was a separate software and the same was not supplied along with the equipments and that the same was not an embedded software in the computer/equipment. The assessee was not the owner of the software, the ownership of the software had remained with the owner; the assessee was just a given license to use the software which was the right to use of copyright in the software. The Tribunal in the said decision (supra) has relied upon the decision of the Hon'ble Karnataka High Court in the case of "CIT vs. Samsung Electronics Company Ltd. & Others" (2012) 345 ITR 494 and upon another decision of the Hon'ble Karnataka High Court in the case of "CIT vs. Synopsis International Old Ltd." (2013) 212 taxman 454. The Ld. DR in this respect has relied upon the amended definition of the 'royality' u/s 9 of the Income Tax Act. It is pertinent to mention here that vide amendment Act of 2012, Explanation 4 has been added to section 9(1)(vi) of the Act with retrospective effect including the software in the definition of royalty. The Ld. DR has stated that the definition of royalty under the Act is parametria with that of the treaty, therefore, the same is to be read into the

definition of treaty as provided in the DTAA for determining the tax liability of the assessee in this respect. The contention of the Ld. AR, on the other hand is that the definition of royalty, since provided in the DTAA is to be looked into only and that the definition, if any, provided under the Act is to be ignored.

13. After hearing the Ld. Representatives of the parties, the first and foremost question for adjudication before us is as to whether the definition of 'Royalty' as provided under the Income Tax Act is to be taken or that which has been provided in the DTAA with Singapore.

14. The Ld. D.R. at this stage relying upon the decision of the Hon'ble Madras High Court in the case of "Vrizon Communication Singapore vs. ITO" 361 ITR 0575 (Mad.) has contended that in 'Para 100' of the said decision, the Hon'ble Madras High Court has observed that the definition of royalty under DTAA and the Indian Income Tax are in paramateria. He has further stated that the said decision of the Hon'ble Madras High Court in the case of "Vrizon Communication Singapore" (supra) has been followed by the Mumbai Bench of the Tribunal in "Viacom 18 Media Pvt. Ltd. vs. ADIT (International Taxation) reported in (2014) 44 taxman.com 1 (Mumbai). He, therefore, has vehemently contended that the definition of royalty as provided under the various clauses and explanations of section 9 of the Income Tax Act should be adopted. He, in this respect, has stated that the Explanation 4 to section 9(1)(vi), introduced vide Amendment Act of 2012, is clarificatory in nature under which the software has been specifically included in the definition of royalty, and it should be read along with the definition of royalty as provided under the DTAA. He therefore has contended that the consideration paid by the assessee for the use of software is to be treated as royalty.

On the other hand the contention of the Ld. AR of the assessee has been that if the provisions of DTAA are more beneficial to the assessee then the same would prevail over the provisions of the Income Tax Act as provided under section 90 of the Income Tax Act. He, in this respect, has relied upon the decision of the Hon'ble Supreme Court in the case of "Union of India vs. Azadi Bachao Andolan" (2003) 263 ITR 607.

15. We have considered the rival contentions of the Ld. Representatives in this respect. We have also gone through the relevant definitions as provided under the DTAA and under the Income Tax Act. So far as the definition of royalty as provided under section 9(1)(vi)of The Income Tax Act is concerned, the relevant part of the said provision is reproduced as under:

Section 9(1)

"(vi) income by way of royalty payable by—

(a) the Government ; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government :

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

Explanation 1.—For the purposes of the first proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date; so, however, that, where the recipient of the income by way of royalty is a foreign company, the agreement shall not be deemed to have been made before that date unless, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139 (whether fixed originally or on extension) for furnishing the return of income for the assessment year commencing on the 1st day of April, 1977, or the assessment year in respect of which such income first becomes chargeable to tax under this Act, whichever assessment year is later, the company exercises an option by furnishing a declaration in writing to the Assessing Officer (such option being final for that assessment year and for every subsequent assessment year) that the agreement may be regarded as an agreement made before the 1st day of April, 1976.

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

Explanation 3.—For the purposes of this clause, "computer software" means 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.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—
(a) the possession or control of such right, property or information is with the payer;
(b) such right, property or information is used directly by the payer;
(c) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;"

16. The definition of "royalty" as provided in the DTAA of India with Singapore, for the sake of convenience and comparison, is also reproduced as under:

" Article 12(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 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 in paragraph 4(b) or 4(c) of Article 8."

17. We further find that in the various treaties with different countries, the Article 12 therein, generally, deals with the payments in respect of royalties and almost identical/similar definition has been provided in various treaties with various other countries.

18. A comparison of the definition of 'royalty' as provided under the DTAA (as reproduced above) with the definition of 'royalty' as provided under Income Tax Act shows that the same are not at paramateria with each other. The definition provided under the DTAA is the very short and restrictive definition, whereas, the definition of the royalty as provided under the Income Tax Act is a very wide and inclusive but vague. A careful reading of the relevant provision under the DTAA and under the Income Tax Act reveals that the DTAA covers only a part of the items mentioned under sub clause (i) to (v) to Explanation 2 to section 9(1)(vi). We may mention here that the section 9(1)(vi) having sub clauses (a), (b), & (c) is very vast to cover consideration paid for any right, property or information used or services utilized for the purpose of business or profession. Further, we find that in the said sub clauses (a), (b) & (c) of section 9(1) (vi), the wording is somewhat vague and negatively written. Even, if we apply and read the negatively written wording in clause (c) in relation to a payment made by a non resident into the clause (b), i.e. in relation to payment made by a resident Indian and read the clause(b) in terms of clause(c), even then what the 'royalty' may constitute will be the income payable in respect of any right, property or information used or services utilized for the purpose of business or profession by such resident to a non resident. However, vide explanation 2 the vast definition provided in sub clauses (a), (b) & (c) of section 9(1) (vi), have been restricted only to the consideration paid for the items as mentioned (i) to (vi) of Explanation 2. However, 'Explanation 4' inserted by Finance Act, 2012, provides that the transfer of rights in respect of any right, property or information includes and has always included the right for use or right to use a computer software including granting of a license. **We find that so far as Income Tax Act is concerned, 'computer software' has neither been included nor is deemed to be included within the scope or definition of 'literary work' in any definition or explanation provided under the Act.** The term 'literary work' has been separately mentioned under clause (v) to Explanation 2 to include the

consideration paid for the same within the scope of royalty, whereas, the term 'computer software' has been specifically included, not under the clause (v) to Explanation 2, but, under the main clause (vi) to section 9(1).

Hence, the computer software has been recognized as a separate item not only in 2nd proviso to clause (vi) but in Explanation 4 also and has been included in the definition and within the scope of the words 'right', 'property' or 'information'. The same has not been included in the meaning and scope of the term 'literary work' under clause (v) to Explanation 2.

It is to be further noted that the consideration paid for 'computer software' has not been specifically included under the definition of royalty under the DTAA.

19. Under the circumstances, the contention of the Ld. D.R. that the definition of royalty as under the Income Tax Act is in paramateria as under the DTAA can not be accepted as it is apparent that the definition under the DTAA is short and restrictive whereas the definition under the Income Tax Act is wide, inclusive and extended. Since the definition provided under the royalty in the DTAA is more beneficial to the assessee, hence as per the provisions of section 90, the definition of royalty as provided under DTAA is to be taken.

So far as the reliance of the Ld. D.R. on the decision of the Hon'ble Madras High Court in the case of "Vrizon Communication Singapore" (supra) and of the Mumbai Tribunal in the case of "Viacom 18 Media Pvt. Ltd." (supra) is concerned, we find that the said decisions have been rendered in context of some other item relating to the consideration paid for transponder/band width/telecom services. In that context, the Hon'ble Madras High Court has interpreted the right to use the 'equipment' and the word 'process' applying the domestic law, definition of which was not available in the DTAA. However, in this case, we have to define the term 'literary work', the term 'copyright';

the definitions of the same are not available under the Income Tax Act, rather, the same are available under the Copyright Act, 1957.

20. Moreover, the Hon'ble Delhi High Court in the case of "DIT vs Nokia networks OY" [2012] Taxmann.com 225 (Delhi) has held that though Explanation 4 was added to section 9(1)(vi) by the Finance Act 2012 with retrospective effect from 1.6.1976 to provide that all consideration for user of software shall be assessable as "royalty", the definition in the DTAA has been left unchanged. In "Siemens AG" 310 ITR 320 (Bom), it was held that amendments cannot be read into the treaty. As the assessee has opted to be assessed by the DTAA, the consideration cannot be assessed as "royalty" despite the retrospective amendments to the Act. The relevant findings of the Hon'ble Delhi High Court as given in para 23 of the said decision, for the sake of convenience are reproduced as under:

> "The decision of the Delhi Bench of the ITAT has dealt with this aspect in its judgment in Gracemac Co. Vs. ADIT 134 TTJ (Delhi) 257 pointing out that even software bought off the shelf, does not constitute a "copyrighted article" as sought to be made out by the Special Bench of the ITAT in the present case. However, the above argument misses the vital point namely the assessee has opted to be governed by the treaty and the language of the said treaty differs from the amended Section 9 of the Act. It is categorically held in CIT Vs. Siemens Aktiongesellschaft, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty. On the wording of the treaty, we have already held in Ericsson (supra) that a copyrighted article does not fall within the purview of Royalty."

21. Further, in a recent judgment in the case of "DIT Vs New Skies Satellite BV," (ITA 473/2012 vide order dated 08.02.2016), the Hon'ble Delhi High Court has observed that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend in operation to the terms of an international treaty. In other words, a clarificatory or declaratory amendment, much less one which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument affected between two sovereign states prior to such amendment. That an amendment to a treaty must be brought

about by agreement between the parties. Unilateral amendments to treaties are therefore categorically prohibited. Even the Parliament is not competent to effect amendments to international instruments. As held by the Hon'ble Supreme Court in "Azadi Bachao Andolan" (2003) 263 ITR 607, these treaties are creations of a different process subject to negotiations by sovereign nations. While relying on the decision of the Hon'ble Madras High Court, in "CIT vs VR. S.RM. Firms & Ors", the Hon'ble Delhi High Court held that the tax treaties are considered to be mini legislation containing in themselves all the relevant aspects or features which are at variance with the general taxation laws of the respective countries. The Parliament is not equipped with the power to, through domestic law, change the terms of a treaty. Amendments to domestic law cannot be read into treaty provisions without amending the treaty itself. It is fallacious to assume that any change made to domestic law to rectify a situation of mistaken interpretation can spontaneously further their case in an international treaty. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change. It is imperative that such amendment is brought about in the agreement as well. Hon'ble Delhi High Court concluded in the said decision (supra) that the Finance Act, 2012 will not affect Article 12 of the DTAAs, it would follow that the first determinative interpretation given to the word "royalty" prior to the amendment in the Income Tax Act will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a Double Tax Avoidance Agreement, unless the said DTAAs are amended jointly by both parties.

22. Further, we find that in all the decisions of the Hon'ble High Courts relied upon by both the Ld. Representatives of the parties i.e. not only in the decisions relied upon by the assessee of the Hon'ble Delhi High Court in the case of "Infrasoft Ltd." (supra) and "Ericson A.B." (supra) but also in the decisions relied upon by the Revenue i.e. "Samsung Electronics Company Ltd. & Others" (supra), "Synopsis International Old Ltd." (supra) and of the

Tribunal in the case of "Reliance Infocom Ltd." (supra), the different Benches of the High Courts and the Tribunal have been unanimous to hold that as per the law laid down by the Hon'ble Supreme Court in the case of "Union of India vs. Azadi Bachao Andolan" (2003) 263 ITR 607, that where a specific provision is made in the DTAA, that provision will prevail over the general provisions contained in the Income Tax Act if, the same is more beneficial to the assessee as provided under section 90 of the Income tax Act. All the Hon'ble High Courts (supra) have also been unanimous to further hold that the definition of 'royalty' is restrictive in DTAA whereas the definition of royalty under the Income Tax Act is broader in its content. Therefore, the definition of royalty in DTAA is more beneficial to the assessee and hence the case of the assessee is to be examined in the light of the definition of royalty as provided in the DTAA and that the provisions of the DTAA will, in such an event, override the provisions of the Income Tax Act. Since, the Ld. AR of the assessee has stated that the definition of treaty in the DTAA with Singapore is more beneficial to the assessee and that the case of the assessee be decided taking the definition as provided in the treaty, hence, in the light of above cited decisions, we proceed to examine as to the consideration paid by the assessee for the purchase of off the shelf software can be covered within the scope of the 'royalty' as provided under the DTAA.

23. From the perusal of the above reproduced definition of royalty as provided in Article 12 in 'Singapore treaty,' it is revealed that it is the payment which is received as consideration for the 'use of' or the 'right to use' "**any copyright of literary, artistic, scientific work including …..**" (emphasis supplied by us). Hence, what is relevant is the consideration paid 'for the use of' or the right 'to use' any 'copyright'. The right to use a computer software/programme has not been specifically mentioned in the treaty with Singapore or even in the identically worded treaty with US and or with any other country.

However, the Ld. DR, at this stage, has stressed on the definition of word 'literary work'. It has been submitted that the definition of 'Literary work' as provided under the domestic law viz. Copyright Act, 1957 should be considered while deciding the scope of the term "Royalty" as defined under the treaty. This issue has been discussed by the Hon'ble Karnataka High Court in the case of "Samsung Electronics Company Ltd. & Others" (supra) while relying upon Article 3 sub section (2) of the DTAA with US, observing that any term not defined in the convention shall, unless the context otherwise requires, have the meaning which it has under the laws of that 'State' concerning the tax to which the convention applies. Hence, the reference is to be made to the respective law of the taxing State (India in this case) regarding the definition of 'literary work' and 'copyright'. The relevant part of the Article 3 of the DTAA with Singapore for the purpose of ready reference is reproduced as under:

> **Art 3**. "(2.) As regards the application of the Agreement by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have, the meaning which it has under the law of that State concerning the taxes to which the Agreement applies."

24. Hence, the question before us, at this stage, is whether the term 'literary work' as mentioned in the definition of royalty in the treaty would include 'software' or not?

We note that the term 'Literary work' covers work, which is expressed in print or writing irrespective of the question of its literary merit or quality. It must be expressed in some material form, i.e. writing or print or in some form of notation or symbols, which means in a form capable of either visually or audibly recreating the representation of the original work. As per the provisions of section 2(o) of the Indian Copyright Act, 1957 the term 'literary work' includes computer programs, tables and compilations including computer data base. Therefore, the computer software has been recognized as a copyright work in India, if they are original intellectual creations.

25. "Computer programme" as defined in the Copyright Act, means a set of instructions expressed in words, codes, schemes or in any other form, including a machine-readable medium capable of causing a computer to perform a particular task or to achieve a particular result. The words 'schemes or in any other form' would seem to indicate that the source code and object code of a computer programme are entitled to copyright protection. It may be noted here that copyright protects the expression of an idea and not the idea itself. The ideas embedded in the software are therefore not protected but the ways by which the ideas are expressed in the source code are protected.

26. In the past, software were often sold as an integral part of the computer system, but now a days, software products are sold or licensed in the form of computer readable media such as diskettes and CD-ROMs or directly over the Internet. Though such floppy disc; the CD-ROM or the Hard Disc are tangible commodities, but, the software embedded in these media devices is intangible.
In the earlier day's customized software was made and the contracts involved two distinct parties who could discuss all the terms of such agreement between them. However, now a days the software become mass market items and are available off the shelf. At the time of sale of such off the shelf software embedded diskettes or CD-ROMs, the rights assigned by the author/owner of the software would be very specific in their scope, indicating clearly to the purchaser the actions that he/she is permitted to perform in relation to the software embedded in those discs.

27. Now, the question before us is as to whether the sale of shrink wrapped /off the shelf computer software by the non-resident to the resident assessee amounts to the transfer for the 'use of' or the right 'to use' any copyright in a literary work. Before deliberating further in this respect, we think it proper to first discuss the nature of the shrink wrapped software.
The words 'shrink wrap' refer to the shrink wrap packaging that generally contain the CD ROM of software. The terms and conditions of accessing the

particular software are printed on the 'shrink wrap cover' of the CD and the purchaser after going through the same tears the cover to access the CD ROM. The typical 'shrink wrap' agreement is a single piece of paper describing the licence terms, contained inside the box and wrapped in transparent paper along with the computer software installation and diskettes or the owner's manual. These agreements contain typical clauses on anti-reuse, anti-reverse engineering and limited copyright provision. Sometimes, these may have clauses disclaiming of warranties and liabilities. End user is bound and is considered to have agreed with the license, if he tears open the package. Shrink wrap agreements do not follow the normal practice of an agreement between the parties, where the terms of an agreement are negotiated between the parties.

The other popular way of transfer/sale or licensing the software is through 'Click Wrap' agreements. In these licenses, software developers do not receive a signed agreement from the user instead of he relies on the customers manifestation of ascent via the internet. The user generally is asked to review the terms of the agreement and indicate the ascent by clicking on the button/icon at the end of the license. The button or the icon provided in these agreements is generally 'I agree' and 'I decline'. The 'I agree' or 'Ok' button/icon constitutes agreement to the 'click wrapped' license agreement. Some times when 'shrink wrapped' software is downloaded on the computer, it may again ask to agree to certain terms as in case of Click wrap software. The purchaser or the end user once has clicked the 'Ok' button he has no right to decline the terms of agreement by returning the software. There is no bargaining involved in these licenses whose terms are set by the licensor.

28. Software contracts, like many other transactions, are governed by the common law principles as embodied in the Indian Contract Act. Contracts can be in the nature of sale or assignment/license. If the computer software is

considered as a 'good', the Sale of Goods Act, 1930 will have relevance in the formation and execution of the sale contract.

In context of copyright law, a license is a permission to do an act that, when the doing of the same without permission, would be unlawful. In Software Licences, the copyright owner retains substantial rights and greater ability to control the use of software. Licence may have provisions relating to the persons who may use the programme, the number of copies that can be made, warranty, limitation of liability, distribution of the software, etc. These are generally biased towards the licensor.

29. The plea raised on behalf of the Revenue is that sale of off-the-shelf software may be easily termed as sale but in such a 'buying', the title to the box, containing disk, manual etc., may pass to the buyer, but the title to IP in the software does not. Hon'ble Karnataka High Court in "CIT vs. Samsung Electronics Company Ltd. & Others" (2012) 345 ITR 494 has observed that under the agreement, what was transferred was only a license to use the copyright belonging to the non-resident subject to the terms and conditions of the agreement and that the non-resident supplier continued to be the owner of the copyright and all other intellectual property rights; that the copyright is a negative right. It is a bundle of many rights and license is granted for making use of the copyright in respect of shrink wrapped software / off the shelf software under the respective agreement which authorizes the end user i.e. the customer to make use of the copyright software contained in the said software, which is purchased off the shelf or imported as shrink wrapped software and that the same would amount to transfer of part of the copyright and transfer of right to use the copyright for internal business of the assessee as per the terms and conditions of the agreement. It was therefore held that the contention of the assessee that there was no transfer of copyright or any part thereof under the agreements entered into by the respondent with the non-resident supplier of software cannot be accepted. The Tribunal in the said case

has also relied upon another decision of the Hon'ble Karnataka High Court in the case of "CIT vs. Synopsis International Old Ltd." (2013) 212 taxman 454 wherein the Hon'ble Karnataka High Court has observed that even in case of end-user software license agreement granted for a non exclusive, non transferable, without right of sub license of use of the licensed software and design techniques, that does not take away the software out of the definition of the copyright. Even if it is not a transfer of exclusive right in the copyright, the right to use the confidential information embedded in the software in terms of the license makes it abundantly clear that there is transfer of certain rights which the owner of a copyright possesses in the said computer software/programme in respect of the copyright. The Hon'ble Karnataka High Court while analyzing the provisions of the DTAA held that the consideration paid 'for the use' or 'right to use' the said confidential information in the form of computer programme software itself constitutes royalty and attracts tax. It has been further held that it is not necessary that there should be a transfer of exclusive right in the copyright. That the consideration paid is for rights in respect of copyright and for the user of the confidential information embedded in the software/computer program, therefore, it falls within the mischief of explanation 2 of clause (vi) of sub section (1) of section 9 of the Income Tax Act and there is a liability to pay the tax in India.

30. However, different benches of the Hon'ble Delhi High Court in the above cited decisions in the case of "DIT vs. Infrasoft Ltd." (supra); "DIT vs Nokia networks OY" (supra) and in the case of "DIT vs. Ericson A.B." (supra) have been unanimous to hold that the license granted to the licensee permitting him to download the computer programme and storing it in computer for its own use is only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purposes. The said process is necessary to make the program functional and to have access to it. 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. The Hon'ble Delhi High Court has observed that in such a case there is no transfer of any right in respect of copyright to the assessee and it is a case of 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. The Hon'ble Delhi High Court has further held that what is transferred is neither can be right in the software nor the use of the copyright in the software, but is the right to use copyrighted material or article which is clearly distinct from the rights in a copyright and the same does not give rise to any royalty income and would be the 'business income'. The Hon'ble Delhi High Court in the case of "Infrasoft Ltd." (supra) has also relied upon another decision of the Hon'ble Delhi High Court in the case of "DIT vs. Nokia Networks OY" (2013) 212 taxman 68 wherein the Hon'ble Delhi High Court has held that the copyright is distinct from material object. It is intangible, incorporeal right in the nature of privilege, quite independent of any material substance such as manuscript. The transfer of the ownership of a physical thing in which copyright exists comes to the purchaser with the right to do with it 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 copyright in it.

31. Now, after going through the divergent views of the different Benches of the High Courts on this issue, the question that arises before us as to whether the sale of shrink wrapped software can be said to be sale of 'Good' or grant of 'License to use'.

Section 2 (7) of the Sale of Goods Act, 1930 defines 'good' as 'every kind of movable property other than actionable claims and money, and includes stock and shares, growing crops, grass....' This definition of 'goods' thus includes all types of movable properties, whether tangible or intangible. The Hon'ble Supreme Court in the case of "Tata Consultancy Services vs State of Andhra Pradesh" 271 ITR 401 (2004), has considered computer software as 'goods' and stated that notwithstanding the fact that computer software is intellectual property, whether it is conveyed in diskettes, floppy, magnetic tapes or CD ROMs, whether canned (shrink-wrapped) or uncanned (customized), whether it comes as part of the computer or independently, whether it is branded or unbranded, tangible or intangible. The Hon'ble Supreme Court held that, 'it would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customized satisfies these attributes, the same would be goods.' The Hon'ble Apex court while citing the decision of the US court in "Advent Systems Ltd v Unisys Corporation" (925) F 2d 670 (3rd Cir 1991), held 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, movable and available in the market place. In such a case, the intellectual property has been incorporated on a media for purposes of transfer. The software and the media cannot be split up.

In "Associated Cements Co. Ltd. vs. Commissioner of Customs", AIR 2001 SC 862, the Hon'ble Supreme Court examined whether the drawings and license could be considered as 'goods'. The Hon'ble Supreme Court held that all tangible, movable articles are goods for charge of custom duties under section 12 read with section 2(22)(e) of the Customs Act, 1962, irrespective of what the article may be or may contain. It may be that what the importer wanted and paid for was technical advice or information technology, an intangible asset, but the moment the information or advice is put on media, whether paper or cassette or diskette or any other thing, that what is supplied, it becomes chattel. The Hon'ble Supreme Court, thus, held that the intellectual property such as drawings, license and technical material when put on a media is to be regarded as an article and there is no scope for splitting the engineering drawings or encyclopedia into intellectual input on the one hand and the paper on which it is scribed on the other hand.

32. No doubt, the dominant object of sale in such transaction is the computer software and not the disk or the CD upon which such software is loaded. As understood by us, what the 'computer programme' or the 'software' is an expression of work/ideas written on a media in a computer programming language and that is why it has been included worldwide in the category of literary work. As per the definition provided in section 2 (ffc) of the Indian 'Copyright Act 1957' "Computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result; As per Explanation 3 to section 9(1)(vi), the computer software has been defined as follows:

" 'computer software' means 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."

Hence, like any other literary work, computer programme can not be read or utilized without downloading on a media like hard disk, CD, floppy or any other such device. As an author of a literary work may be having some ideas in his mind in an intangible form but the copyright in those ideas is created when they are expressed in a particular manner in the shape of some impressions, symbols or language or visuals etc. on a media such as book, film or CD or screen etc. Now a days not only the computer programmes but also the other literary work can be transmitted over the internet from one media/computer to the other media /computer. But these expressions of ideas called literary work including computer programmes can not be read or utilized without downloading or writing them on a media. Hence, though the same as a result of advancement in technology can be transmitted in an intangible form, but to constitute a literary work, these have to be transformed into a tangible form.

Computer programmes in itself can not be equated and categorized into an intangible material or right a such as a business or commercial right like copy right, right to practice some profession or noncompeting right etc.; Hence once incorporated on a media, it become a 'goods' and itself is not a copy right; however a copy right can be created in respect of such ideas expressed on a media. Further the copyright doesn't protect the idea itself but only protects the way or the manner in which such ideas are expressed.

33. Further, it is also not disputed that in case of shrink wrapped software, the product is available off the shelf in the market. The owner or the licensor does not invite any expression of interest from the intending users of the product. He does not grant license by seeing the names and details of the persons seeking the license to use software rather the situation is a diagonally opposite. The license is not granted to any specific person; anybody can purchase the product from the market which is available in the shape of CD ROM/diskette falling in the definition of 'goods' as defined under the sale of Goods Act, 1930. Whosoever pay the price of the good, he is supposed to have right to use that good. On the completion of the sale, the property in such a good passes to the buyer and the buyer has every right of fair use of the said product and subject to the conditions mentioned in the shrink wrap/cover of the product which are in the shape of restrictions or limitations to the effect that the buyer will not misuse the product which may amount to infringe of copyright in the product. So what the buyer purchases is the copyrighted product and he is entitled to fair use of the product. The restriction or the terms mentioned in the paper/cover are the conditions of sale restricting misuse and can not be said to be license to use. However, the purchaser is entitled to perform all or any of the activities which is essentially required for the fair use for the purpose for which the product is purchased by him. Section 52 of the Copyright Act expressly recognizes such a right of the purchase which we will discuss in later part of this order.

Further, the computer software as generally observed has a shorter life cycle. When a shrink wrapped software is sold, the owner gets the price of the copy of the product/work. Even if the owner/licensor has fixed the duration or the time limit for the use of the product, on the expiry of which the same becomes unusable, he in-fact receives the price for the expected life of the work and product. In such case the purchaser pays the price for the product itself and not the license to use.

34. The next contention of the Revenue is that in case of software Licenses, the copyright owner gives a license to use the copyright in the software and that the owner of software exercises power over not only the software itself but also over people who may wish to use the software and that the owner of the software decides who will use his work. It has therefore been strongly contended on behalf of the Revenue that it is the right given to use the copyright in the software.

35. This contention, though, on the face of it may seem to be quite plausible or reasonable, however, when we examine the nature of the transactions in case of shrink wrapped software, we are of the view that the above contention is not so true. In our view, in case of shrink wrapped software, what is sold is the CD ROM or diskette wrapped in a transparent cover and in a paper put inside the cover, the conditions of use along with restrictions and limitations of use of the said article/product are mentioned. In our view, the sale of such a CD ROM/diskette is not a license but it is a sale of a product which of course is a copyrighted product and the owner of the copyright puts the conditions and restrictions on the use of the product so that his copyrights in the copyrighted article or the work, which has been written on such CD ROM/diskette, may not be infringed. Such conditions, in our view, are not the license to use the product. The purchaser gets the right to use the product/diskette along with the property in the 'good' in the shape of work embedded or written in it when the sale

is complete i.e. when such diskette/COD ROM is delivered by the seller to the purchaser in lieu of the consideration paid to him. Thus what is restricted by the so called agreement or commonly used software license is that the user will not infringe the copyrights in the product of the copyright owner of the work. The purchaser is always entitled to fair use of the work which he has purchased. Thus at the most, what can be said to be granted under such a license is the right to use the copyrighted work and the right to use the copyright itself in the work. What is prohibited through these conditions is its misuse which may infringe the rights of the owner of the software e.g. the purchaser of the product may attempt as it is easy in case of software to make copies etc. These license agreements in case of shrink wrapped software are thus the conditions of the sale of the product and cannot be termed as a grant of license to use the product.

36. Further, a question, which needs to be examined whether the statutory rights of the purchaser/user of the software can be curtailed or done away by the terms of the above explained shrink wrapped or click wrapped mass licenses/ agreements. Firstly there are severe doubts about the enforceability of such agreements. In the so called internet license agreement, the end user is supposed to click the icon 'I agree' which means that the end user has agreed to the terms of the license agreement. However, it may be noted that such agreements do not ask the name or address or other details of the user. It is not mentioned in such type of agreements that who is using the product. It is the computer upon which such software is loaded that can be said to have agreed to abide by the terms of the software license as the user remains unidentifiable. In such type of software licenses, there are certain inbuilt mechanism made by the buyer preventing the misuse or infringement of the copyright in the product; the moment the end user attempts to violate such conditions, such software becomes inoperative on the computer or sometimes also damage

the other data/applications on the computer. However, for the enforceability of such license agreement it is not known who is actual user or which person actually has violated the terms of the agreement. Suppose, in case of a company a product is purchased by the staff of the company, for its use in regular course of work or business of the company and an employee of the company while installing the software on the computer in the office of the company clicks the button or the icon 'I agree' and thereafter such an employee or any other employee of the company violates any condition of the license agreement, can such license agreement be enforced against the company or the Directors of the company can be held liable for any such infringement, especially when they are not signatories to such an agreement and nor they have authorized any employee of the company to sign any agreement on behalf of the company and even no name of the company is even written in such type of agreement and even it is also not known as to who actually clicked the button 'I agree'. Under these circumstances, the enforceability of such a license is highly doubtful.

So far as the legal enforceability of such a Licence Agreements is concerned, in spite of the fact that it may fulfill all the requirements of a valid contract, such an agreement may not be enforceable, if, its stipulations conflict with the law governed in the country where such licenses are intended to be enforced, or if it is an unconscionable or unreasonable bargain. In computer software, generally it is the tendency of software producers to do away with the rights and privileges of the user, even which are specifically conferred upon the user by the relevant laws such as Copyright Act, Contract Act and other relevant laws. The fair use of the purchased article is the other plea which contradicts the license theory. As per the provisions of section 52 of the Copyright Act 1957, which has provisions similar to the provisions of section 117 of the US Copyright Act, the owner of a copyright of computer software is legally entitled to fair use that copy of software even without a license from the software publisher and any condition put in a license restricting the fair or reasonable use of the product purchased by the buyer in that respect will have to be ignored. If the license severely limits the rights of the consumers, such as implied conditions and warranties in a contract, it cannot be enforced. If in the license agreement, there are certain conditions which are in violation of the provisions of the Contract Act, then such conditions cannot be enforced and even under some circumstances, the whole contract can be held to be void. These terms of the mass software license are in the shape of 'standard terms' which the licensee or the user of the product often ignores while accepting the license before downloading the software. The courts in India in such a situation have opined that such standard conditions put in a contract which are often in the form of standard format and being so much detailed and numerous and are generally not read by the other party/buyer of the product, should be fair and any unfair condition restricting the users' rights relating to the goods or the services availed of, which can be held to be unreasonable and against the public policy, cannot be enforced. Thus these licenses create a clear conflict between copyright law and contract law, which have different purposes and objectives. The technological restrictions such as encryption technology and transactional design having restrictions on the development, use, services, may be called in question under the Competition Act, 2002 also. Further the condition in the agreement that the ownership of each copy of software would remain with the software publisher and that the user will have only right to use the software is to be looked in terms of the Indian Contract Act to arrive at a conclusion whether such a condition is reasonable and is not against the public policy or whether it is restricting the fair use of right of the user/purchaser of the product. It is also a determinative factor as to whether the property in the goods after buying off the shelf product in case of shrink wrapped software has passed on to the purchaser or not as per the provisions of Sale Of Goods Act 1930.

37. As discussed above, in case of shrink wrapped software, the work is embedded in the diskette/CD ROM which is when sold to the buyer in retail transaction as in case of 'sale of goods' and consequently on the completion of the sale, the property in such goods passes to the buyer. The user/purchaser of the CD ROM or the diskette is the owner of the copy and in such a case, a license is not technically required in order for the purchaser to use the copyrighted product/software for his own/ business use. So what the buyer buys is the copyrighted product and he is entitled to fair use of the product as is provided under section 52 of the Copyright Act. He is also entitled to perform all or any of the activities which is essentially required for the fair use and for the purpose for which the product is purchased by the buyer.

38. It may also be pointed out here that even, if, such a license agreement is not signed by the end user still the owner of the product will have the copyrights in such a product, as are defined and explained under the Indian Copyright Act; even the registration of the product or the work under the Copyright Act is not compulsory. The owner of the work is deemed to be protected in relation to the copyrights in the work but the fair use of the product/work cannot be denied and any clause in such agreement should be deemed to be void as against the principle of fair use of the product.

39. Further, to determine whether a copyright in a work is infringed or not or would be deemed to be infringed or not, the most important test is to find out whether the use is likely to harm the potential market or the value of the copyright work. When it is not the allegation of the owner/purchaser of the work that the purchaser/user was reproducing the work and

distributing it so as to affect his potential market in exercising the reproduction right, then it cannot be said that the user has infringed the rights of the purchaser, who in fact has paid the consideration to use the copyrighted work. The use of information in the work by the purchaser for which he purchases such a product/diskette/CD ROM is thus comes within the scope of fair use. Copyright does not protect the fair or exclusive use of the information rather, the purpose of copyright protection is to regulate the dissemination of information viz. production of the copies of the copyrighted work/information and distribution thereof. The use of information *viz.* a new technology or invention can, however, be protected under the Patents Act, 1970. However, it is pertinent to mention here that even under the Patents Act 1970, the computer Software can not be patented. The computer software, subject to certain exception, have been specifically excluded from patentable items under the Patents Act, 1970.

40. At this stage, we think it appropriate to discuss here the relevant provisions of the Copyright Act, 1957 also. The copyright has been defined under section 14 of the Copyright Act, 1957 as under:

> "14. Meaning of copyright – For the purposes of this Act, 'copyright' means the exclusive right subject to the provisions of this Act, to do or authorize the doing of ay of the following acts in respect of a work or any substantial part thereof, namely:
>
> (a) in the case of a literary, dramatic or musical work, not being a computer programme, -
>
> (i) to reproduce the work in any material from including the storing of it in any medium by electronic means;
> (ii) to issue copies the work to the public not being copies already in circulation;
> (iii) to perform the work in public, or communicate it to the public;
> (iv) to make any cinematograph film or sound recording in respect of the work;
> (v) to make any translation of the work;
> (vi) to make any adaptation of the work;
> (vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-cls. (i) to (vi);
>
> **(b) in the case of a computer programme**,-

(i) to do any of the acts specified in cl. (a);

(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

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

……………………”

41. Section 51 of the copyright is also relevant which deals as to when the copyright is infringed which for the sake of convenience is reproduced as under:

“CHAPTER XI

Infringement of Copyright

51. When copyright infringed. -Copyright in a work shall be deemed to be infringed-

(a) when any person, without a licence granted by the owner of the copyright or the Registrar of Copyrights under this Act or in contravention of the conditions of a licence so granted or of any condition imposed by a competent authority under this Act-

(i) does anything, the exclusive right to do which is by this Act conferred upon the owner of the copyright, or

(ii) permits for profit any place to be used for the communication of the work to the public where such communication constitutes an infringement of the copyright in the work, unless he was not aware and had no reasonable ground for believing that such communication to the public would be an infringement of copyright; or

(b) when any person-

(i) makes for sale or hire, or sells or lets for hire, or by way of trade displays or offers for sale or hire, or

(ii) distributes either for the purpose of trade or to such an extent as to affect prejudicially the owner of the copyright, or

(iii) by way of trade exhibits in public, or

(iv) imports into India, any infringing copies of the work

Provided that nothing in sub-clause (iv) shall apply to the import of one copy of any work for the private and domestic use of the importer.

Explanation.- For the purposes of this section, the reproduction of a literary, dramatic, musical or artistic work in the form of a cinematograph film shall be deemed to be an "infringing copy"

42. Certain provisions of section 52 of the Copyright Act which are relevant are also reproduced as under:

“52. Certain acts not to be infringement of copyright.-(1) The following acts shall not constitute an infringement of copyright, namely:

(a) a fair dealing with a literary, dramatic, musical or artistic work 104 [not being a computer programme] for the purposes of-private use, including research; criticism or review, whether of that work or of any other work;"

(aa) the making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copy-
in order to utilize the computer programme for the purposes for which it was supplied; or
to make back-up copies purely as a temporary protection against loss, destruction or damage in order only to utilise the computer programme for the purpose for which it was supplied;"

(ab) the doing of any act necessary to obtain information essential for operating inter-operability of an independently created computer programme with other programmes by a lawful possessor of a computer programme provided that such information is not otherwise readily available;

(ac) the observation, study or test of functioning of the computer programme in order to determine the ideas and principles which underline any elements of the programme while performing such acts necessary for the functions for which the computer programme was supplied;

(ad) the making of copies or adaptation of the computer programme from a personally legally obtained copy for non-commercial personal use;"

43. The proviso to section 57 of the Act is also relevant. The said section 57 of the Act of 1957 is also reproduced as under:

"57. [Author's special rights. (1) Independently of the author's copyright and even after the assignment either wholly or partially of the said copyright, the author of a work shall have the right-

(a) to claim authorship of the work; and
(b) to restrain or claim damages in respect of any distortion, mutilation, modification or other act in relation to the said work which is done before the expiration of the term of copyright if such distortion, mutilation, modification or other act would be prejudicial to his honour or reputation:

Provided that the author shall not have any right to restrain or claim damages in respect of any adaptation of a computer programme to which clause (aa) of sub-section (1) of section 52 applies."

44. A perusal of the above provisions of the copyright Act reveals that the computer software is included in the definition of literary work and is covered under the purview and scope of copyright. The exclusive rights to do or authorize the doing of certain acts as mentioned in clause (a) and clause (b) of section 14 vests in the owner of the work and as per section 51 of the Act,

copyright in a work shall be deemed to be infringed when any person without license granted by the owner of the copyright or in contravention of the conditions of a license so granted does anything, the copyright of the owner is stated to be infringed.

However a perusal of the above provisions of the Copyright Act also reveals that even in some cases unauthorized uses of a copyright work is not necessarily infringing. An unlicensed use of the copyright is not an infringement unless it conflicts with one of the specific exclusive rights covered by the copyright statue. Further there are certain exceptions also. As per the proviso to sub clause (iv) to the clause (b) to section 51, import into India of one infringing copy of any work for the private and domestic use of the importer will not be considered as infringement.

Further, the section 52 of the Act provides for certain other exceptions and the doing of such acts as mentioned under section 52 is not considered as infringement of the copyright as per the statute.

In case of software, it has been provided that making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme from such copy in order to utilize the computer programme for the purpose of which it was supplied or to make back-up copies purely as a temporary protection against loss, destruction or damage and in order to utilize the computer programme and further the doing of any act necessary to obtain information essential for operating inter operatability of an independently created computer programme with other programmes in case such information is not otherwise readily available, the observation, study or test of functioning of computer programme with determination, the ideas and principles necessary for the functions for which the computer programme was supplied and the making of copies or adaptation of computer programme from a personally and legally obtained copy from non-commercial personal use, have been excluded from the definition of infringement of

copyright. Even import of one infringed copy of the work for private and domestic work of the importer has been excluded from the scope of infringement of Copyright under the Act.

45. **It is also pertinent to mention here that the Income Tax Act does not specifically include the 'computer software' in the term 'literary work' and under such circumstances, if we apply the same analogy to the treaty, then perhaps the 'computer software' will be out of the scope of the treaty.** However, if we apply the Copyright Act, then the 'computer software' will have to be included in the term 'literary work' but to constitute 'royalty' under the treaty, the consideration should have been paid for the use of or the right to use the **copyright in the 'literary work' and not the 'literary work' itself.**

46. Further, when we read the definition of copyright and literary work as provided in the Copyright Act, 1957, it is also important to note down that what constitutes infringement of copyright and what are the exceptions to it. If the software purchased by the assessee and the use of it by the assessee is covered within the exceptions as provided under section 52 of the Copyright Act, then in that event it cannot be said that the transfer of right to use or for use of the copyright has passed. The proviso to section 57 of the Copyright Act has further clarified that the author of the work shall not have right to restrain or claim damages in respect of any adaptation of a computer programme to which clause (aa) of sub section (1) of section 52 applies.

47. Further **in case of imported software** i.e. if the original work has been published outside India, as per the provisions of the Copyright Act, apart from the work being original and not copied from elsewhere, **the work should be first published in India** or if the work is published outside India, the author on the date of publication, if the author is dead, at the time of his death, should be **citizen of India**. In case of unpublished work, the author on the date of making of a work should be a citizen of India or domicile in India. Section 40

of the Copyright Act 1957, provides for International Copyrights. As per the section 40 of the Act, the Government of India may by an order published in the official gazette direct that all or any provisions of this Act shall apply to the work published or unpublished in any territory outside India. Such a right is extended in relation to countries which have entered into a treaty or which are a party to a convention relating to rights of the copyright owners and have undertaken to make such provisions in their laws in relation to the Indian authors for protection of their rights in their country. Section 40, 40A and section 41of the Copyright Act, 1957 are relevant in this respect. Section 42 of the Copyright Act, however, put certain restrictions on the rights in works of foreign authors first published in India wherein it has been provided that if a foreign country does not give adequate protection to the works of the Indian authors, the Central Government may direct that such of the provisions of the Act as confer copyright on works first published in India of the foreign authors shall not apply. So if a foreign country recognizes the copyrights of the Indian authors in their copyrighted work, the India also allows the copyright to the foreign authors on reciprocal basis. So a foreign author can claim the copyright in a product, if India has a treaty with that country or if India and that other country are signatories of the certain international treaties or conventions e.g. Berne convention to which India is a signatory. **Under such circumstances, in respect of works done in foreign countries or by foreign authors, the copyright does not automatically flow or extended to them. The rights of the foreign author are to be examined in the light of the Copyright Act and the relevant treaty or the convention, if any, signed by India with that country to which the foreign author belongs. The copyright in a foreign product thus does not flow automatically or impliedly, so far as the Indian copyright laws are concerned.**

48. Hence, while interpreting the definition of ‘royalty’ as provided in the DTAA, it is to be seen as to what has been purchased by the assessee i.e.

whether the 'copyright' itself has been purchased or what the assessee has purchased is only a 'copyrighted work'. It is also required to be analysed as to whether the use of such right would amount to infringement of copyright if a license or permission in this respect is not given by the owner; and when assessee has purchased a copyrighted product i.e. off the shelf software, whether the use of the same for the business purpose of the assessee is covered within the exceptions as provided under section 52 of the Copyright Act. Further, in case of imported work/product, whether the protection of copyright is available to the foreign author in terms of section 40,40A, 41 and 42 of the Copyright Act 1957.

49. The provisions of the Copyright Act, as discussed above are clear and unambiguous in this respect. If the assessee has purchased a copy of a computer software programme and he uses the said copy for his business purpose and if the said use falls within the scope and purview of the exceptions of section 52, such as the use of it for the purpose for which it is supplied and to make backup copies for temporary purpose as a protection against loss or damage and doing of any act necessary to obtain information essential for operating the software for the purpose for which it is purchased etc. as provided under section 52, then in that event it cannot be said to be an infringement of copyrights of the author or owner of the work. As held by the Hon'ble Karnataka High Court in the case of "Samsung Electronics Company Ltd. & Others" (supra) while relying upon Article 3 sub section (2) of the DTAA with US as the identically worded article being there in almost all the tax treaties with other countries, that any term not defined in the convention shall, unless the context otherwise requires, have the meaning which it is under the laws of that 'State' concerning the tax to which the convention applies. In view of above, when we see the definition as per the statutory provisions/domestic law of the country i.e. Copyright Act,1957 of India which is the taxing State in this case, it is apparent that the fair use of the work for

the purpose of which it is being purchased and doing of such other acts including making of copy for protection from damage or loss can not, in any case, said to be any infringement of copyright whether or not any license in this respect has been granted by the author/owner of the work. The right to use or for use of the product accrues to the purchaser by the operation of the statute and as held by the Hon'ble Delhi High Court in the case of "Infrasoft Ltd." (supra), the same would amount to the sale of a goods and the acts done such as downloading of the same to the computer or making backup copies etc. would be the necessary acts for enabling the use of the product and would not amount to the transfer of copyright or right therein, but only the transfer of the copyrighted product and thus will not be covered under the definition of royalty under DTAA. The consideration, thus, paid will be the business income of the non-resident and taxable in accordance with the provisions of DTAA. We may clarify here that even in cases where the owner of the copyrighted work may restrict the use of or right to use the work by way of certain terms of the license/software agreement, the validity or the enforceability of the same may be subject matter in other laws such as Indian Contract Act 1872 , Sale of goods Act 1930 or the Consumer Protection Act 1986 etc., but, the same in any way can not be said to grant of or infringement of copyright in the light of specific statutory provisions of Copyright Act 1957.

50. Now coming to the facts of the case in hand, the DRP has given a specific finding of fact that what the assessee in the present case has purchased is the shrink wrapped /off the shelf software. It has also been discussed in detail in paras above that the definition of 'royalty' given in the treaty is more beneficial to the assessee as compared to the provisions of section 9 of the Income Tax Act and the assessee has opted for the definition that is provided under the DTAA, thus as per section 90 of the Income Tax Act, definition of 'royalty' as provided in the DTAA will prevail as over the general definition of 'royalty' provided under the Income Tax Act. Hence, without expressing our

opinion or any view in relation to the definition of 'royalty' vis-à-vis 'computer software' as provided under the Income Tax Act, we have given our findings only in respect of the scope of 'royality' under the DTAA.

51. In view of our detailed discussion made above, the assessee can not be said to have paid the consideration for use of or the right to use copyright but has simply purchased the copyrighted work embedded in the CD- ROM which can be said to be sale of 'good' by the owner. The consideration paid by the assessee thus as per the clauses of DTAA can not be said to be royalty and the same will be outside the scope of the definition of 'royalty' as provided in DTAA and would be taxable as business income of the recipient. The assessee is entitled to the fair use of the work/product including making copies for temporary purpose for protection against damage or loss even without a license provided by the owner in this respect and the same would not constitute infringement of any copyright of the owner of the work even as per the provisions of section 52 of the Copyright Act,1957.

52. Even otherwise, the Revenue has not cited any direct case law of the jurisdictional High Court of Bombay before us. In the case laws cited by the Revenue of the Hon'ble Karanatka High Court in the matter of "CIT vs. Samsung Electronics Company Ltd." (supra) and "CIT vs. Synopsis International Old Ltd." (supra) though a view in favour of the Revenue has been taken, but, the Hon'ble Delhi High Court in the case of "DIT vs. Infrasoft Ltd." (supra) which is a latter decision and has discussed the Samsung case also has taken the view in favour of the assessee. The Hon'ble Delhi High court has taken the identical view favouring the assessee in the case of "DIT vs Nokia Network" (supra) and in the case of "DIT vs. Ericson A.B." (supra) also. The Hon'ble Bombay High Court in the case of "The Addl. Commissioner of Sales Tax vs. M/s Ankit International," Sales Tax Appeal No.9 of 2011 vide order dated 15 September, 2011 while relying upon the decisions of the Hon'ble Supreme Court in "The Commissioner of Income Tax V. Vegetable

Product Ltd." (1973) 88 ITR 192 and in "Mauri Yeast India Pvt. Ltd. V. State of U.P." (2008) 14 VST 259(SC) : (2008) 5 S.C.C. 680 has held that, if two views in regard to the interpretation of a provision are possible, the Court would be justified in adopting that construction which favours the assessee. Reliance can also be placed in this regard on the decision of Hon'ble Supreme Court in "Bihar State Electricity Board and another vs. M/s. Usha Martin Industries and another : (1997) 5 SCC 289. We accordingly adopt the construction in favour of the assessee.

In view of our discussion made above, this issue is accordingly decided in favour of the assessee.

53. In view of our observations made above, the appeal of the assessee is treated as allowed for statistical purposes.

Order pronounced in the open court on 29.02.2016.

Sd/-	**Sd/-**
(D. Karunakara Rao)	**(Sanjay Garg)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai, Dated: 29.02.2016.

* Kishore, Sr. P.S.

Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT (A) Concerned, Mumbai
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.