$~

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

9.

\+ **ITA 890/2015**

THE PRINCIPAL COMMISSIONER OF INCOME TAX-6 ..... Appellant

Through: Mr Rahul Chaudhary, Senior Standing Counsel with Mr Raghvendra Singh, Junior Standing Counsel,

versus

M. TECH INDIA P. LTD. ..... Respondent

Through: Mr Ved Jain and Mr Pranjal Srivastava, Advocates.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

O R D E R

% 19.01.2016

VIBHU BAKHRU, J

1. The Revenue has filed this appeal under Section 260A of the Income Tax Act, 1961 (hereafter 'Act') assailing an order dated 31st March, 2015 passed by the Income Tax Appellate Tribunal (hereafter 'Tribunal') in ITA No. 3893/Del/2012 and C.O. No. 352/Del/2012. By the aforesaid order, the Tribunal rejected the appeal and the cross objections preferred by the Revenue and the Assessee respectively against an order dated 30th April, 2012 passed by the Commissioner of Income Tax Appeals [hereafter

'CIT(A)'], which in turn was preferred by the Assessee against the assessment order dated 28th December, 2010 in respect of the assessment year (AY) 2008-09.

2. In its appeal, the Revenue has projected the following questions of law:-

> "2.1 Whether in the facts and circumstances of the case, ITAT was justified in law in overlooking explanation 2, 4, 5 to section 9(1)(iv) of the Income Tax Act, 1961?
>
> 2.2 Whether in facts and circumstances of the case, the ITAT, was justified in law in deleting disallowance of Rs.72,23,496/- and Rs.13,78,496/- made by the Assessing officer under section 40(a)(i) and 40(a)(ia) of the Act respectively by without considering that payments were in nature of royalty subject to TDS under section 195 and 194J of the Act respectively?
>
> 2.3 Whether in the facts and circumstances of the case, the ITAT was justified in law in deleting the disallowance of Rs.61,342/- under section 40(a)(ia) of the Act by overlooking provision of 194C which specifically include passenger transport as a work?
>
> 2.4 Whether in facts and circumstances of the case, the ITAT was justified in law in holding that no TDS was required on the payments of Rs.61,342/- to the contractor for hiring taxi which was contrary to the law laid down by Hon'ble Supreme Court in case of Associated Cement Co. Ltd. v. CIT – (1993) 2011 ITR 435 (SC)"

However, the learned counsel for the Revenue has restricted his arguments

to the deletion of disallowance of Rs. 72,23,496/- and Rs. 13,78,496/- made by the AO under Section 40(a)(i) and 40(a)(ia) of the Act respectively.

3. The controversy relates to certain payments made by the Assessee. According to the Assessee, it had made those payments for the purchase of software and it was asserted that the Assessee is a Value Added Reseller (VAR) of the software in question. The Revenue on the other hand contends that the payments made by the Assessee were in the nature of royalty and, therefore, the Assessee was obliged to withhold tax on such payments. Since the Assessee had failed to do so, the expenditure incurred by the Assessee was liable to be disallowed under Section 40(a) of the Act.

4. Briefly stated the relevant facts are as under:-

4.1 The Assessee entered into an agreement with M/s Track Health Pty. Limited, Australia (hereafter 'THPL') captioned "VAR Agreement". The Assessee had also entered into an agreement with M/s Speed Miners, Malaysia which is stated to be similar to the 'VAR Agreement' entered into by the Assessee with THPL. In terms of the agreements, the Assessee had paid a sum of Rs. 66,87,509 and Rs. 9,35,987/- to THPL and M/s Speed Miner respectively. According to the AO, the said payments of Rs.

66,87,509/- and Rs.9,35,987/- were in the nature of 'royalty' and since the Assessee had not withheld any tax, the AO disallowed the same under Section 40(a)(i) of the Act.

4.2 The Assessee had also entered into a similar agreement with M/s Intersystems India Pvt. Ltd., Gurgaon in terms of which the Assessee had paid a sum of Rs. 13,78,496/- without deducting any tax at source. This expenditure was disallowed by the AO under Section 40(a)(ia) of the Act.

4.3 Aggrieved by the assessment order, the Assessee preferred an appeal before the CIT(A). In the appellate proceedings the Assessee submitted that it was a Value Added Reseller (VAR) of software related to healthcare and hospitality. The said software was purchased from THPL under the 'VAR Agreement' and the same was resold to various end-users in India. During the financial year relevant to the AY 2008-09, the Assessee had purchased software worth Rs. 66,87,509/- from THPL. In addition, the Assessee had also purchased software from M/s Speed Miners, Malaysia for Rs. 9,35,987/- and M/s Data Innovation Asia Limited, Hong Kong for Rs. 5,03,894/-. The Assessee claimed that similar purchases made in the preceding years had been considered as purchases and allowed as a deduction in computing its taxable income. However, the AO had sought to

treat such payments as royalty in the AY 2008-09. The **Assessee** contended that being a reseller of products, the payments made by the Assessee for acquiring the products could not be considered as royalty. The Assessee relied on the decision of this Court in ***CIT v. Dynamic Vertical Software India P. Ltd .***: (**2011) 332 ITR 222 (Del)** and also sought to distinguish the Tribunal's earlier decision in ***M/s Microsoft Corporation and Ors. v. ADIT*****: 2011 (8) ITR (Trib) 522 (Delhi)**, which was relied upon by the AO.

4.4 The CIT(A) took note of the Assessee's submission that while the AO had treated similar payments to M/s Data Innovation Asia Limited as made for the purchase of software, it had treated the payments made to THPL and M/s Speed Miners as royalty and, thus, the decision of the AO was self-contradictory. The CIT(A) accordingly accepted the Assessee's contention that the payments made by it for the purchase of software from THPL and M/s Speed Miners were not royalty. With regard to the disallowance of Rs. 13,78,496/- made under Section 40(a)(ia), the CIT(A) found that the transactions were identical to the ones entered into by the Assessee with THPL and M/s Speed Miners and, therefore, the payments made to Intersystems India Pvt. Ltd., Gurgaon were also held to be on account of purchases. The CIT(A) accepted the Assessee's contention that it was not

obliged to deduct any tax at source on such payments. Consequently, the CIT(A) directed the deletion of the additions made by the AO in the sum of Rs. 76,23,496 under Section 40 (a) (i) and Rs. 13,78,496/- under Section 40(a)(ia).

4.5 Aggrieved by the CIT(A)'s order dated 30th April, 2012, the Revenue preferred an appeal before the Tribunal. The Tribunal concurred with the decision of the CIT(A) that the payments in question made to THPL and M/s Speed Miners, Malaysia were for purchasing software and the payments made could not be considered as royalty. The Tribunal further held that the decision of this Court in ***Dynamic Vertical Software India P. Ltd .*** (*supra*) squarely covered the issue raised and following the aforesaid decision, rejected the Revenue's contention. For similar reasons, the Tribunal also rejected the Revenue's contention that the payments made by the Assessee to Intersystem India Pvt. Ltd., Gurgaon were to be disallowed as deductions under Section 40(a)(ia) of the Act.

5. In the aforesaid background, the following question arises for consideration:

> Whether in the facts and circumstances of the case, the Tribunal was justified in deleting the disallowance of Rs.72,23,496/- and

Rs.13,78,496/- made by the Assessing Officer under section 40(a)(i) and 40(a)(ia) of the Act. respectively

6. Mr Rahul Chaudhary, Senior Standing Counsel appearing for the Revenue submitted a copy of the "VAR Agreement" and submitted that the payments made under the said Agreement were not for the purchase of software but were in the nature of royalty. He drew the attention of the Court to clause 4.2 (d) of the Terms and Conditions of the said Agreement which entitled the Assessee "to customise the Software for the purposes of End Users". On the strength of the aforesaid Clause, he contended that the Agreement entitled the Assessee to use the software and, therefore, the payments were royalty within the meaning of Explanation 2 to Section 9(1)(vi) of the Act. He next referred to Section 14 of the Indian Copyright Act, 1957 ('CR Act') and contended that the definition of 'Copyright' would mean an exclusive right to do or authorise any of the acts listed in clause (a) of Section 14 of the CR Act including the right to reproduce the work in any material form; storing of it in any medium by electronic means; and/or to make any adaptation of the work. He argued that by virtue of Section 14(b)(i) of the CR Act, all of the acts specified in Section 14(a) would also be applicable in the case of a computer programme. Mr. Chaudhary then referred to the decision of the Karnataka High Court in ***CIT v. Samsung***

Electronics Co. Ltd.: (**2012**) **345 ITR 494 (Kar.)** in support of his contention that computer software is recognised as a copyright work and the payments made by an Assessee for import of the software would be payments for transfer of copyright and the same would fall within the definition of the term 'royalty'. He then referred to the decisions of Authority for Advance Ruling (AAR) in ***Citrix Systems Asia Pacific Pty Ltd., In Re*****: (2012) 343 ITR 1 (AAR)** and ***Skillsoft Ireland Ltd., In Re***: **(2015) 376 ITR 371 (AAR)** in support of his contentions.

7. Mr Ved Jain, learned advocate appearing for the Assessee supported the decision of the CIT(A) and the Tribunal. He also referred to the decisions of this Court in ***Dynamic Vertical Software India P. Ltd.*** (*supra*) wherein the payments made by a reseller for purchase of software for sale in the Indian market was held not to be royalty. He also referred to the decision of this Court in ***Director of Income Tax v. Infrasoft Ltd.*****: (2014) 220 Taxman 273 (Del)** and drew the attention of this Court to paragraph 98 of the said judgment wherein this Court had unequivocally expressed that it was not in agreement with the decision of the Karnataka High Court in the case of ***Samsung Electronics Co.*** (*supra*).

8. Mr Jain also referred to paragraph 3 of Article 12 of the Double

Taxation Avoidance Treaty between India and Australia and contended that the payments made to THPL did not fall within the definition of royalty under the said Treaty.

9. We have heard the learned counsel for the parties.

10. The Assessee had entered into a "VAR Agreement" with THPL. Paragraph 1.1 of the said agreement expressly indicates that THPL had appointed the Assessee (described as VAR) to *"market and sell the products"* in the Territory. Article 2 of the said Agreement provides for "VAR's Obligations". Clause (a) of paragraph 2.1 of Article 2 expressly provides that the Assessee *"Shall promote, market and sell the Products in accordance with a business plan which shall be submitted to Trak within three (3) months of the effective date of the Agreement*". Paragraph 4.2 entitles the Assessee to, *inter alia*, use the software and source codes for a limited purposes to sell and promote the software for use by third parties; demonstrate the software to third parties; and to customise the software for the purposes of End Users. The said agreement further contains a number of covenants to ensure that the Intellectual Property Rights in respect of the software, related material and source codes remains with THPL. A plain reading of the aforesaid agreement indicates that the Assessee has been

appointed for the purposes of reselling THPL's software.

11. The CIT(A) found that the Assessee was engaged in the resale of software and the payments made by it to THPL and others were on account of purchases made by the Assessee. The ITAT concurred with the aforesaid finding. It is also not disputed that in the preceding years, the AO had accepted the transactions in question to be that of purchase of software. The limited issue to be addressed is whether in view of these findings the amount paid by the Assessee could be taxed as royalty.

12. In the cases where an Assessee acquires the right to use a software, the payment so made would amount to royalty. However in cases where the payments are made for purchase of software as a product, the consideration paid cannot be considered to be for use or the right to use the software. It is well settled that where software is sold as a product it would amount to sale of goods. In the case of ***Tata Consultancy Services v. State of Andhra Pradesh*: (2004) 271 ITR 401 (SC)**, the Supreme Court examined the transactions relating to the purchase and sale of software recorded on a CD in the context of the Andhra Pradesh General Sales Tax Act. The court held the same to be goods within the meaning of Section 2(b) of the said Act and consequently exigible to sales tax under the said Act. Clearly, the

consideration paid for purchase of goods cannot be considered as 'royalty'. Thus, it is necessary to make a distinction between the cases where consideration is paid to acquire the right to use a patent or a copyright and cases where payment is made to acquire patented or a copyrighted product/material. In cases where payments are made to acquire products which are patented or copyrighted, the consideration paid would have to be treated as a payment for purchase of the product rather than consideration for use of the patent or copyright.

13. A Coordinate Bench of this Court has also expressed a similar view in the case of ***Infrasoft*** *(surpa).* In that case, the Revenue sought to tax the receipts on sale of licensing of certain software as royalty. The Tribunal held that there was no transfer of rights in respect of the copyright held by the Assessee in the software and it was a case of mere transfer of copyrighted article. This Court concurred with the Tribunal and held that what was transferred was not copyright or the right to use a copyright but a limited right to use the copyrighted material and that did not give rise to any royalty income.

14. Insofar as the reliance placed by the Revenue on the decision of the Karnataka High Court in ***Samsung Electronics Co.*** *(supra)* is concerned, a

Coordinate Bench of this Court in ***Infrasoft*** *(supra)* has unequivocally expressed its view that it was not in agreement with that decision. Thus, the said decision is of no assistance to the Revenue in this case.

15. In another case, ***Dynamic Vertical Software India P. Ltd.*** (*supra*), this Court had reiterated the view that payment made by a reseller for the purchase of software for sale in the Indian market could by no stretch be considered as royalty.

16. In the aforesaid view, the question framed must be answered in the affirmative, that is, in favour of the Assessee and against the Revenue.

17. The Appeal is accordingly dismissed. In the circumstances the parties are left to bear their own costs.

VIBHU BAKHRU, J

S.MURALIDHAR, J

JANUARY 19, 2016
RK