IN THE INCOME TAX APPELLATE TRIBUNAL

MUMBAI BENCHES "L", MUMBAI

BEFORE SHRI AMIT SHUKLA (JUDICIAL MEMBER)

AND

SHRI ASHWANI TANEJA (ACCOUNTANT MEMBER)

I.T.A. Nos.83 & 84/Mum/2007
(Assessment Years: 1998-99 & 1999-2000)

Qad Europe B.V. C/o BSR & Co. KPMG House 448, Kamala Mills Compound Lower Parel (E), Mumbai-13	vs	The Dy. Director of Income-tax (International Taxation)-2(1) Mumbai
PAN : AAACQ0534E		
(Appellant)		(Respondent)

Appellant by	S/Shri PJ Pardiwala / Jitendra Jain
Respondent by	Shri Harshad Vengurlekar, Sr DR

Date of hearing	:	03-11-2016
Date of order	:	21 -12-2016

O R D E R

Per ASHWANI TANEJA, AM:

This appeal has been filed by the assessee against the order of Commissioner of Income-tax (Appeals)-V, Mumbai [in short, CIT(A)] dated 19-09-2006 passed against the assessment order dated 237-1-2003 u/s 143(3) of the Act for AY. 1998-99 on the following grounds:

*"**Ground 1- Assessment under Section 147 is bad in law***
1.1 The learned Commissioner of Income-tax (Appeals) - V, Mumbai ['the CIT(A)'] erred in upholding the AO's action of issuing notice under Section 148 of the Income-tax Act, 1961 ('the Act') and subsequently passing an order under Section 143(3) read with Section 147 of the Act

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The Appellant submits that the re-assessment is bad in law and action of the CIT(A) of upholding the action of the AO be reversed.

Ground 2 - Re-characterization of income received from licensing of software as 'Royalty' and consequent disallowance - Rs. 14,400,044

2.1 The learned CIT(A) erred in upholding the disallowance made by the Assessing Officer (AO) in respect of income received from licensing of software by re-characterizing the same as 'Royalty' under the Double Taxation Avoidance Agreement ('DTAA') between India and Netherlands.

2.2 The learned CIT(A) failed to appreciate that the income was in the nature of business income and in the absence of a Permanent Establishment (PE) in India would not be taxable in India.

2.3 The Appellant submits that the disallowance of Rs. 14,400,044 made by the AO and confirmed by the learned CIT(A) is unwarranted and be deleted.

Ground 3 - Treatment of the Appellant as not being the beneficial owner of the income from licensing of software (without prejudice to Ground 1 above)

3.1 The learned CIT(A) erred in upholding the finding of the AO in taxing the income received from licensing of software @ 20% on the grounds that the Appellant is not the beneficial owner of the income.

3.2 Without prejudice to Ground I above, the Appellant submits that the AO be directed to treat the Appellant as the beneficial owner and therefore, charge tax @ 10% as applicable to beneficial owners of royalty under the DT AA between India and Netherlands.

3.3 Without prejudice to Ground 2.2 above, the Appellant submits that, if QAD Inc. (the Parent company) is treated as the beneficial owner of such income, the applicable rate of tax should be 15% as per Article 12 relating to 'royalties and fees for included services' under the DTAA between India and the United States of America

Ground 4 - Taxation of income from maintenance of software @ 20% on the ground of the Appellant not being held to be the beneficial owner thereof

4.1 The learned CIT(A) erred in upholding the finding of the AO that the Appellant is not the beneficial owner of the maintenance service income and therefore, the beneficial rate of 10% under the DTAA between India and Netherlands would not apply to it.
4.2 The learned CIT(A) failed to appreciate that the maintenance and support services in relation to such software was provided by the Appellant and as such was the rightful owner of such income.
4.3 The Appellant therefore submits that the higher tax rate of 20% applied by the learned AO and confirmed by the learned CIT(A) on this count is unwarranted and be deleted."

2. **Ground 1** was not pressed during the course of hearing, therefore, dismissed.

3. **Ground 2:** In this ground, the assessee is aggrieved by the action of the lower authorities in re-characterisation of income received from licensing of software as 'Royalty' under the Double Taxation Avoidance Agreement (DTAA, in short) between India and Netherlands after disregarding the claim of the assessee that the aforesaid income was in the nature of business income and in absence of permanent establishment (PE) of the assessee in India, it would not be taxable in India.

4. The brief facts are that the assessee is a non resident and filed its return declaring total taxable income (comprising of maintenance service charges) of Rs 3,30,45,600/-. The assessee's case was reopened by the AO u/s 147 on the ground that amount received by the assessee in the form of maintenance of software should be taxed as "Fee for Technical Services". In the assessment order, the AO treated the income received by the assessee from sale of licence of software as royalty income amounting to Rs.1,44,00,044/-. The claim of the assessee was that the

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aforesaid income was not liable to be taxed as royalty income but it was in the nature of business income and the same was not taxable in absence of PE of the assessee in India. But, Ld CIT(A) did not accept the submission of the assessee and upheld the order of the AO.

5. During the course of hearing before us, the Ld. Counsel of the assessee made detailed arguments to demonstrate that the transaction of sale of software by the assessee company to Indian customers did not give rise to any kind of transfer of right in the copyright. Our attention was drawn upon various agreements entered into between the assessee and the Indian customers and foreign holding company of the assessee. Our attention was also drawn on various clauses of the master agreement entered into by M/s Quad Inc. with Unilever N.V for sale of licensed products, i.e. ERP software by the said company or through its subsidiaries to Unilever group. It was demonstrated that various clauses of the agreement suggest that there was no transfer of copyright. Our attention was further drawn upon the provisions of DTAA between India and Netherlands to show that the payment made for software was not included within the definition of 'Royalty'. Reliance was placed on this issue on the judgement of Hon'ble Bombay High Court in the case of Mahyco Mosanto Biotech (India) (P) Ltd vs UOI (2016 74 taxmann.com 92(Bom) and DIT vs Reliance Industries Ltd 69 taxmann.com 311 (ITAT, Mum).

6. Per contra, the Ld. DR relied upon the orders of the lower authorities. It was submitted that the assessee had right to make adaptation and also to make copies. It was further submitted that in this case source-code was also given to the assessee which was a unique

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feature. It was further submitted that beneficial ownership of the software was not with the assessee, and therefore treaty benefits should not be given since treaty provisions will not be applicable under such circumstances.

7. In the rejoinder, the Ld. Counsel submitted that the lower authorities have not properly appreciated the facts of this case. The clauses of the agreement clearly reveal that the ownership rights were not transferred. The rights were given only for the limited purpose of use by the customer or its group companies. No rights were given for commercial exploitation of the software. With regard to the beneficial ownership, it was submitted that the lower authorities have not appreciated the facts properly. The assessee was clearly and undoubtedly the beneficial owner of the income received from sale of software. Our attention was drawn upon various replies submitted before lower authorities wherein it was demonstrated that the assessee was the beneficial owner of the software business done with the customers in India. Therefore, the entire risk and responsibilities and returns of the business were enjoyed by the assessee. Our attention was also drawn upon the financial statements showing that huge value addition was made by the assessee. Further, our attention was also drawn upon the tax residency certificate issued by Netherland tax authorities to show that the assessee company was tax resident of Netherland. Under these circumstances, the assessee should be deemed to be the beneficial owner of software business.

8. We have gone through the facts and circumstances of the case. The brief background is that assessee, viz. Qad Europe B.V. is a company incorporated in Netherlands. It is also a tax resident of Netherlands. It is a 100% subsidiary of Qad Inc., USA (in short, Qad Inc.) which is the ultimate parent company of Qad group. Qad Inc. was engaged during these years in the development and sale of Enterprise Resource Planning (ERP) software products. As per the global arrangement, the said company acted as a distributor of aforesaid software products only in USA and Latin American countries, whereas the other Qad group companies worldwide, including the assessee company, undertook marketing responsibilities for countries other than USA and Latin American countries.

9. During the years before us, the assessee company purchased software from Qad Inc. and resold the same to multinational companies outside USA and Latin American countries. These facts were demonstrated with the help of financial statements of the assessee company. Further facts are that Qad Inc. had entered into a multinational software product licence agreement dated 01-06-1977 (called as 'Master Agreement') with M/s Unilever N.V., a multinational company incorporated in Netherlands for sale of licensed product, i.e. ERP software either directly or through its subsidiaries to M/s Unilever N.V. (UNV, in short) and its subsidiaries for a consideration to be received either from UNV or through any of its subsidiaries, as the case may be. In pursuance to the said Master Agreement, the assessee company entered into another agreement with M/s Hindustan Lever Ltd (HLL, in short), which is an Indian subsidiary of UNV for the sale of licensed product, i.e. ERP software by the assessee company to HLL. Now, in pursuance to the agreement entered into with HLL, ERP software was sold by the assessee company to HLL. Income arsing from the said transaction was treated as

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business income by the assessee company, and in absence of any PE in India, the same was not offered to tax in India. But, according to the AO, the payment received by the assessee company on account of sale of ERP software product to HLL amounted to payment of 'Royalty' by HLL to assessee and, therefore, it was held as taxable in India in the hands of the assessee company u/s 9 (1)(vi) of the Act.

10. This issue has come up repeatedly before us in many cases. Therefore, before taking a decision on the facts of this case, we deem it appropriate to take guidance from the judgement of **Hon'ble Bombay High Court** wherein identical issue was involved, in the case of **Mahyco Mosanto Biotech (India) (P) Ltd** (supra) wherein while analysing this issue Hon'ble High Court observed as under:

> *"At this stage, we find that a parallel to practical, every-day examples would be useful. Take, for instance, the example of when one buys a book from Amazon for their Kindle device. In this case, Amazon can transfer the intellectual property of the book to multiple other users simultaneously, but each single transaction would still be a sale. This would also be true of the example of a music CD. The CD is the 'medium' by which the intellectual property, viz. the songs, passes to the buyer. The manufacturer can sell it to an end-user or to an intermediate retailer. The same song can be put on countless CDs. This too is a sale. When one buys a car, one buys the technology that is contained in the body of the car; the body is just the medium. On ITunes, when one buys a song, the song is transferred into a format which is accessible to the buyer, a proprietory format that needs a special device or software. Yet it is a sale. Limitless ITunes users can buy the song simultaneously. This is a sale to each of them. In the case of CD containing software, say for example Microsoft Word, the medium would again be the CD holding the intellectual property, which would be the software technology. This would also be a sale, despite the fact that this same software technology could be put on unlimited number of CDs and sold to multiple users simultaneously. Effective control of that*

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particular software on that one CD is passed to the buyer. The buyer could use it, alienate it, destroy it, and do anything at all that he likes with it. If he made illicit copies of it, this would constitute infringement; and that in itself would not make the transfer of the software on a CD a service. Even if the buyer transferred this non-transferable software, it would amount to a breach of contract provided in the CD package, just as it would under Monsanto India's sub-licensing agreement. However, this does not do anything to disqualify the transaction itself from being a sale. These are all sales.

Para 46. In fact, we believe that this sub-licensing of the Bollgard technology may possibly even be an outright sale. For a transaction to qualify for a sale, there must be a transfer of the property in the goods. In legal usage, the word ''property'' is a generic term, of broad and extensive application; perhaps, the most comprehensive of all terms which can be used. Property embraces everything which is or which may be subject to ownership of any kind at all, and is legally understood to include every class of acquisitions that a man can own or in which he can have an interest. The rights that transfer of property cover are the right of acquisition, possession, use, enjoyment and disposition.

Para 47. We pause here momentarily to consider the nature of these intangible goods. We believe this is necessary, because this is perhaps a case where the law is yet evolving to keep abreast of technology. If what Mr. Venkatraman suggests is correct, then every sale of software as we currently know it is never a sale but only a service. In his formulation, the 'medium' (CD, pen drive, etc) is irrelevant. Surely this cannot be correct. Software may be downloaded too, without any 'physical medium' intervening - the medium is as intangible as the goods. It is impossible, we think,and does not stand to reason to suggest that unless, say, Microsoft or Adobe wholly cede all control over their software products there is no sale, and when they allow a user to download and use their software they are only providing a service. Indeed, this is demonstrably incorrect. Microsoft and Adobe both have alternative distributions models. One may 'purchase' a license to Microsoft Office or Adobe Photoshop. This may be a one-off, standalone product, delivered either by download or on physical media. That is for the user to keep and do with it what he wishes (except, of *course, attempting to decompile it). He does not have to use it all; he can destroy the media and all personal copies of it. The same software is also available nowadays for a subscription - for an annual or monthly fee, the software can be downloaded and used; if the subscription ends, at the very least updates end and very possibly the software will not function optimally. The latter may be a service, very like car rental or book borrowing from a library. The former is clearly a sale. The difficulty with Mr. Venkatraman's argument is that it tries to draw a completely unnecessary distinction between the technology and the medium in which it is delivered. Neither is the subject of the levy. The subject of the levy is not the technology nor the medium. It is the license; and the terms of that license are determinative. Where a license is purchased, it is still a sale, although what the user has 'purchased' is the right to use the software. Every license has a unique key and every sale is therefore uniquely identified. The purchase is therefore a transfer of the right to use that particular, identified software. The proprietory rights to the software do not have to be 'sold' or 'transferred '. Microsoft and Adobe retain all those rights, and all intellectual property continues to vest in them. This is, therefore, a transfer of the right to use that software, and to that extent, the intangible (the software) is sold; but the terms of that license allow the software vendor to retain complete seizin and dominion over all intellectual property rights. The transfer is not of those intellectual property rights, but of the right to use an identified and identifiable version of that software. In the subscription distribution model, where the software usage is dependent on payment of a periodic fee, there is no such transfer, and there is a mere right to use, without any transfer of that right to use even that particular download. So long as the fee is paid, the software may be used; when the fee payment stops, so does the right to use. This exactly parallels car or book rentals. The determinant in such a case must, therefore, be whether the license is such that the licensed intangible is with the licensee in perpetuity or whether the licensor has the right to terminate and repossess and deny further access to that intangible. In a software sale, there is no question of termination or repossession. It is for the licensee to use forever.* ***<u>This is clearly a sale or a deemed sale and it is in respect of not the medium or the intellectual property (the marks, copyright, patents, etc), but is the transfer of the right to use that software subject to those marks, patents, copyright, etc.</u>***

> ***Monsanto India's case is no different.*** *Its sub-licensee do not acquire any proprietory intellectual property rights over the Bollard Technology; Monsanto India's and its parents' patents, copyright, marks and other intellectual property rights are preserved intact, unaffected by the sub-licensing. But the identified technology, the one infused in the fifty seeds given to the sub-licensee, is for the sub-licensee to use as he wishes. Viewed from this perspective, Mr. Venkatraman's clients' underlying fears are, we believe, unfounded." (emphasis supplied)*

11. Identical issue also came up before the co-ordinate bench of ITAT in the case of **DDIT vs Reliance Industries Ltd** (supra) wherein the bench analysed the provisions of copyright and discussed in detail its applicability to determine whether there would be any transfer of copyright at the time of sale of software. The observations of the Hon'ble Bench can be summarised as under:

> *" 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 such as to reproduce the work, to issue copies, to make translation or adaptation, to sell or give on commercial rental in respect of a work. The internal use of the work for the purpose it has been purchased does not constitute right to use the copy right in work. Our above also finds support from certain other provisions of the Copyright Act."*

12. Thus, from the above judgments, it may be noted that in the above said cases it has been held that in absence of transfer of rights to authorise doing of certain acts as mentioned in sections 2, 13 & 14 of the Copyright Act it cannot be said that there was transfer of copyright. Therefore, in view of these judgments it was vehemently argued that the payment on sale of software shall not fall within the definition of 'Royalty', as per DTAA.

13. Turning back to the facts of this case, it is noted that the rights and obligations of the parties, i.e. the assessee and its customer, viz. HLL flow

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from the Master Agreement. Therefore, the relevant clauses of this agreement were examined by us, and are reproduced below:-

"Article 2-Licenses:

2.1 Grant: Upon issuance of a Purchase Order by any Participant to QAD, QAD shall, in consideration of the license fee to be paid, ***grant to such Participant a non-exclusive, non-transferable license, for perpetual use****, to use the Products on one (1) Hardware System at the Site designated in the Purchase Order in accordance with the terms and conditions established in this Agreement. Such license shall include the right to use the English language version of the licensed Products and one (1) additional language version at the Site. For purposes of this license grant, a Hardware System may include up to four (4) servers at anyone Licensed Participant.*

Ownership Rights: Licensed Participants ***shall not acquire any rights of ownership*** *in the Products. Licensed Participants acquire only the right to use the Products subject to the terms of this Agreement.*

Backup Copies: Licensed ***Participant may copy*** *the Products for* ***safekeeping (archival) or backup purposes****, provided that all such copies of Products are subject to the provisions of this Agreement, and also provided that each copy shall include in readable format any and all confidential, proprietary and copyright notices or markings contained in the original.*

2.3 Assignment: The rights granted herein are ***restricted for use solely by Licensed Participants and may not be assigned, transferred,*** *or sub licensed, except as explicitly agreed under this Agreement as set forth in Article 13.6, without the prior written permission of QAD. Each Licensed Participant shall be authorized to make use of the Products in the form in which they are provided to Licensed Participant (machine readable object code) solely for Licensed Participant's own internal data processing operations. Licensed Participant agrees not to use the Products for timesharing, rental or service bureau.*

Article 4-Transfer of Programs on Hardware System-Upgrade of License:

4.3 Upgrade Fee: A license to Programs may be Upgraded, such as to a higher number of users classification, by payment of QAD of an Upgrade fee equal to the difference between the then current license fee list price in effect for Participant for the licensed

Programs at the desired Upgrade level and the license fees paid to date for that license.
Article 9-Modiflcation Rights:
9.1 Modifications: QAD provides some portions of Products in source code form and other portions in object code form. Participant may modify any source code. ***<u>Participant may not modify any portion of the object code. Participant may not use QAD Products without object code modules.</u>*** *The object code contains license number, date of license and other license information. This information is placed in the object code portions to prevent unauthorized and unlicensed distributions of the Products. Participant may not subvert or change any of this information.*
9.2 Ownership of Modifications: ***The parties hereby agree that the ownership of all intellectual property rights*** *embodied in, or by, any modification to the Programs created by, or for, Participant under this Agreement,* ***shall vest solely in QAD.*** *Participant hereby assigns all rights title and interest in all such modifications to the Products to QAD."*
<u>(emphasis supplied in bold and underline)</u>

14. On the basis of analysis of the relevant clauses of the Master Agreement and other facts brought before us, salient features of the agreement defining rights and obligations of the parties can be summarised as under:-

i) The assessee Company has granted to HLL a non-exclusive, non-transferable, license for perpetual use.

ii) The license was for use of Product on one Hardware System. A Hardware System may include up to four servers.

iii) HLL did not acquire any copyrights in the product.

iv) The license could be used by HLL alone and HLL was not permitted to assign, transfer or sublicense.

v) HLL was permitted to use the license for the purpose of its own operation and was not permitted to exploit it commercially.

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vi) It was explained that a source code is a computer programme written in any of the several programming languages employed by computer programmers. An object code is the version of a programme in which the source code language is converted or translated into the machine language of the computer with which it is to be used. The object code is an adaptation or mechanical translation of the source code entitled to copyright protection.

It was emphasised that though HLL was permitted to modify source code but was not permitted to modify object code. The Agreement granted limited rights to HLL permitting to change source code so as to make the product compatible to the local laws and regulations like Service Tax etc. The said change in the source code could not be operational till the object code was modified by the assessee company. Hence, the limited right of modification qua the source code granted to HLL cannot be viewed adversely.

vii) The rights in modification to Programs shall vest in QAD.

viii) The Computer Program is governed by The Copyright Act, 1957.

ix) HLL is not permitted to do any act referred to in Section 14 of the Copyright Act, 1957.

x) The assessee Company has therefore not granted to HLL any right in a copyright.

15. Having examined various clauses of the agreement, we have also gone through relevant provisions of the Copyright Act, 1957. It was noted by us that as per section 2(a) of the Copyright Act, 'adaptation' means,-

i) in relation to a dramatic work, the conversion of the work into a non-dramatic work;

ii) in relation to a literary work or an artistic work, the conversion of the work into a dramatic work by way of performance in public or otherwise;

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iii) in relation to a literary or dramatic work, any abridgement of the work or any version of the work in which the story or action is conveyed wholly or mainly by means of pictures in a form suitable for reproduction in a book, or in a newspaper, magazine or similar periodical;

iv) in relation to a musical work, any arrangement or transcription of the work; and

v) in relation to any work, any- use of such work involving its rearrangement or alteration;

16. Now, if we analyse and compare various provisions of the Copyright Act with the relevant clauses of the master agreement, it is noted that the said agreement does not permit HLL to carry out any alteration or conversion of any nature, so as to fall within the definition of 'adaptation' as defined in Copyright Act, 1957. The right given to the customer for reproduction was only for the limited purpose so as to make it usable for all the offices of HLL in India and no right was given to HLL for commercial exploitation of the same. It is also noted that the terms of the agreement do not allow or authorise HLL to do any of the acts covered by the definition of 'copyright'. Under these circumstances, the payment made by HLL cannot be construed as payment made towards **'use'** of copyright particularly when the provisions of Indian Income-tax Act and DTAA are read together with the provisions of the Copyright Act, 1957.

17. Further, it is also noted by us that DTAAs of few countries make a specific mention that payment made for software would be included within the definition of 'Royalty'. Reference can be made to the DTAA with Malayasia, Romania, Kazakhistan and Morocco. However India Netherlands DTAA does not include software while defining 'Royalty'.

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Under these circumstances, we find that it would be difficult to characterise the payment received by the assessee on account of sale of software as payment received on account of 'Royalty'.

18. It is further noted by us that identical issue came up before the Delhi Bench of the Tribunal in the case of **Datamine International Ltd Vs Addnl DIT (in ITA No5651/Del/2010 Order dt 14-03-2016)** wherein various contentions were raised by the revenue to argue that the payment received on account of sale of software would amount to 'Royalty' for various reasons. The Bench discussed all the arguments made by the Revenue in detail and held that the payment made on account of software shall not fall within the definition of ''Royalty''. Relevant part of the order of the Bench is reproduced hereunder:

> *"5. Now, we espouse the `End user Agreement' between Datamine Corporate Ltd. and the end-user of the software products, who purchases such software through the assessee, a distributor of the software product. A copy of this Agreement is placed at page 122 onwards of the paper book. Clause 'Usage rights' clearly states that Datamine Corporate Ltd. (DCL) grants to the end user: 'the perpetual right to use the number of seats of the software products.' It further provides that: 'the perpetual right to use the software refers only to the version of the product that was available when the purchase was made and does not entitle you to receive further updates or enhancements to the software…..'. A significant clause of the Agreement states that: 'This agreement does not transfer the intellectual property rights to the products to you.' Then, there have been specified certain dos and do nots, which are as under:-*
>
> *"Under this agreement you may:*
>
> *a. Install the software on any number of computers over which you have control; b. make copies of the software in machine readable form for backup purposes; c. Make copies of any documentation for your use only; and d. execute as many simultaneous copies of the software*

products as you have purchased seats.
You may not:
a. Contrive for the software to be executed by more than the number of simultaneous users for which you have purchased seats; b. modify, translate, reverse engineer, decompile, disassemble or create similar or derivative software programs based on software products you have purchased; or c. assign, rent or lease any rights in the software or accompanying documentation in any form to any third party without the prior written consent of DCL or its authorized channels which, if given, is subject to the third party's consent to the terms and conditions of this agreement."

6. This clause fairly indicates that the end user can install the software on any number of computers, make copies for back up purposes for his own use only but with the qualification that he cannot operate/execute simultaneous copies of the software product more than the purchased seats. For example, if three copies of a product are purchased, these three software can be installed in any number of computers, but, at a time the usage cannot by of more than three seats. If only one copy is purchased, that can be installed by the end customer on any number of computers, but, at a time only one can be used. Then, there is a warranty clause in this Agreement which provides that the warranty duration varies from product to product and during such warranty period, the Datamine group will repair any programme error that may have been found. A perusal of the above clauses of the End user Agreement divulges that the end user acquires perpetual right to use the software and the number of permissible seats to the user is equal to the number of copies purchased. It further shows that intellectual property rights vest in Corporate alone and the end user has simply a right to use the product, which is albeit perpetual.

7. Under such circumstances, the question arises as to whether the sale of software can be treated as `Royalty' as held by the authorities or `Business receipts' as canvassed by the assessee. The ld. AR was fair enough to concede that Explanation 4 to section 9(1)(vi) inserted by the Finance Act, 2012 with retrospective effect from 1.6.1976 brings consideration for right to use a computer software within the ambit of `Royalty'. It was, *however, submitted that the DTAA has not been correspondingly amended in line with the section 9(1)(vi) of the Act, so as to bring payment for right to use a computer software within the purview of Article 13 of the DTAA. This argument was vehemently countered by the ld. DR, who submitted that insertion of Explanation 4 to section 9(1)(vi) should also be read into the DTAA and thus going by the language of Article 13 of the DTAA as so amended, the case of the assessee falls within the same.*

8. 1. We first take up the contention of the ld. DR that the retrospective amendment to the provisions of the Act should be considered for determining the taxability of the amount even under the DTAA. This contention, in our considered opinion, is partly correct. Any amendment carried out to the provisions of the Act with retrospective effect shall no doubt have the effect of altering the provisions of the Act but can not per se have the effect of automatically altering the analogous provision of the Treaty. There are certain provisions in some Treaties which directly recognize the provisions of the domestic law. For example, Article 7 in certain Conventions provides that the deductibility of expenses of the permanent establishment shall be subject to the provisions of the domestic law. In such a case, if any retrospective amendment is made to the provisions of the Act governing the deductibility of the expenses, the same shall apply under the Treaty as well.

8.2. Article 3(3) of the DTAA provides that any term not defined in the Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of that State concerning tax to Which the Convention applies. The nitty-gritty of Article 3(3) in the present context is that if a particular term has not been defined in the Treaty but the same has been defined in the Act and further there is a retrospective amendment to that term under the Act, then it is this amended definition of the term as per the Act, which shall apply in the Treaty as well. If however a particular term has been specifically defined in the Treaty, the amendment to the definition of such term under the Act would have no bearing on the definition of such term in the context of the Convention, unless the DTAA is also correspondingly amended. A country which is party to a Treaty cannot unilaterally alter its provisions.

An amendment to a Treaty can be made bilaterally after entertaining deliberations from both the countries who signed it. If there is no amendment to the provision of the Treaty but there is some amendment adverse to the assessee in the Act, which provision has been specifically defined in the Treaty or there is no reference in the Treaty to the adoption of such provision from the Act, then such amendment will have no effect on the DTAA.

8.3. Reverting to the facts of the extant case, we observe that the term "Royalties" has been defined in the DTAA as per Article 13(3). Such definition of the term "royalties" as per this Article is exhaustive.

Pursuant to the insertion of Explanation (4) by the Finance Act, 2012, with retrospective effect, no corresponding amendment has been made in the DTAA to bring the definition of `Royalties' at par with that provided under the Act. Subject matter of the Explanation 4 is otherwise not a part of the definition of `Royalties' as per Article 13 of the DTAA. As such, it becomes vivid that the contention of the learned

Departmental Representative that the retrospective insertion of Explanation 4 to section 9(1)(vi) should be read into the DTAA also,cannot be accepted.

9. Now we proceed to evaluate the contention of the ld. AR that the provisions of the DTAA do not permit taxability of receipt from sale of

software as `Royalties', defined as per Article 13, whose relevant part

reads as under : -

ARTICLE 13

Royalties and fees for technical services

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

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

> *(3) For the purposes of this Article, the term "royalties" means :*
> *(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent,trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and*
> *(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic."*

10. Para 1 of this Article provides that `Royalties' arising in India and paid to a resident of UK may be taxed in UK. Para 2 provides that such royalties may also be taxed in India. As the assessee is a resident of UK,income from royalties arising in India, is otherwise chargeable to tax in India at the stipulated rate of tax. But in order to tax any amount under this Article, it is sine qua non that the receipt must fall within the scope of `Royalties' as defined in para 3 of the Article 13. The AO has enclosed the case of the assessee within sub-para (a) of para 3. It is apparent that sub-para (b) of para 3 of Article 13, dealing with consideration for the use of any industrial, commercial or scientific equipment etc., has absolutely no relevance in the present context as no equipment has been transferred by the assessee to the end users, which is simply a software. Now coming to sub-para (a) of para 3 of the Article, we find that the term `royalties' has been defined to mean a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

11. The Department has covered the case with in the four corners of this Article on two counts. First is that the consideration from the alleged sale of software is nothing, but, for `use' of 'process'. In our considered opinion, this approach is not correct because the assessee has not allowed end users to use any `process'. Obviously, a `computer software' cannot be treated as a `process' because the end users by using the software do not have any access to the source codes. What is available for their use is software product as such and not the processes embedded in it. To cite an example, when we purchase a refrigerator and place vegetables etc. into if for cooling, what we use for cooling is refrigerator and not its in-built processes or technology which facilitated in the manufacturing of a refrigerator. In the same manner, several processes may be involved in making a computer software, but the customer uses the software as such and not the processes involved into it. We, therefore, refuse to accept the view point of the Revenue that the assessee received consideration from end users for the use of or the right to use any `process'.

12.1. As regards second count, the ld. DR accentuated on the language of para 3(a) of the Article 13 to canvass a view that the assessee received the amount for allowing use of copyright in the mining software. A bare perusal of this para deciphers that the term 'royalties' has been defined to mean a consideration for the use of or the right to use any `copyright of literary, artistic or scientific work …, patent, trademark and design etc.' This contention raised on behalf of the Revenue needs to be dealt in two segments. Firstly, we find that there is no specific mention of `computer software' in para 3(a) of the Article 13 along with literary, artistic or scientific work, patent, trademark etc. Such language of the DTAA is in sharp contrast to the specific use of the term `computer software' or `computer software programme' together with literary,artistic or scientific work, patent, trademark etc. in many DTAAs. To illustrate, Article 12 of the DTAA between India and Malaysia defines 'Royalties' to mean `payments of any kind received as consideration for the use of or right to use any copyright of a literary, artistic or scientific work……….. plan, know how, computer software programme, secret formula or process…..' Similarly, the DTAA

between India and Kazakhstan defines the term 'royalties' in Article 12(3)(a) to mean :
'payments of any kind received as a consideration for the use of or the right to use any copyright of literary, artistic or scientific work including software, cinematograph films…'. Similarly, the DTAA with Turkmenistan also defines `Royalties' in Article 12 to mean : 'payments of any kind received as consideration for the use of or the right to use any copyright of literary, artistic or scientific work, ….. computer software, any patent, trade mark…'. It is thus clear that wherever the Government of India intended to include consideration for the use of software as 'Royalties', it explicitly provided so in the DTAA with the concerned country. Since Article 13(3)(a) of the DTAA with UK does not contain any consideration for the use of or the right to use any `computer software', the same cannot be imported in to it.
12.2. The second segment, which is quite pertinent, is that Article 13(3)(a) encompasses consideration for the use of or the right to use any copyright of literary, artistic or scientific work etc. as `Royalties'. Even if we presume for a moment, with which we do not agree, that a
computer software is covered with in any of the terms specifically mentioned in the Article, such as `information concerning commercial
experience etc.', then also the instant sale consideration cannot be brought within the purview of Article 13. This is for the reason that in order to be covered within the scope of this Article, it is necessary that user should get a copyright of `information concerning commercial experience' etc. and not the output or products of `literary work', or `information concerning commercial experience etc. There is a marked distinction between the use of any copyright of a literary work etc. and use of a literary work etc. as such. Whereas the use of copyright of literary or artistic work, etc., enables the user to take copies of such literary or artistic work etc. for its purpose, the simplicitor user of such literary or artistic work, etc., does not confer in the user any such right to copy.
12.3. At this juncture, it becomes relevant to see as to whether the end customers have been given a copyright of the software or the software as such. The ld. DR harped on the relevant parts

of the assessment order to put forth that it has been specifically mentioned in the End user Agreement that the customer gets simply the right to use the product under the license, which is non-transferrable. It was argued that there are several restrictions placed as per the terms of the license which prevent the customer from using it as per its own sweet will.

12.4. This contention of the ld. DR can be better appreciated after having a look at the relevant sections of The Copyright Act. Section 14 of this Act defines `Copyright' to mean : `the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely :-

"a. in the case of a literary, dramatic or musical work not being a computer programme,-

i. to reproduce the work in any material form including the
storing of it in any medium by electronic means,
ii. to issue copies of the work to the public not being copies
already in circulation,
iii. to perform the work in public, or communicate it to the
public,
iv. to make any cinematograph film or sound recording in respect of the work,
v. to make any translation of the work
vi. to make any adaptation of the work
vii. to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub clauses (I)
to (vi)

b. in the case of a computer programme-

(i). to do any of the acts specified in clause (a)
(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme :

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.*

……….

Explanation - For the purposes of this section, a copy which has been sold once shall be deemed to be a copy already in circulation."

12.5. When we consider the relevant parts of the End user Agreement, it clearly emerges that the customers have not been assigned any of the things which have been mentioned in section 14 of the Copyright Act, so as to constitute an assignment of a copyright of the computer software to the end user. Insofar as the view point of the ld. DR about the taking of copies of the Software by the end customer is concerned, we find that the same is for self use and thus covered by section 52 of the Copyright Act, which enumerates certain acts that do not amount to infringement of copyright. The relevant part of this provision is as under : -

"(1) The following acts shall not constitute an infringement of copyright namely

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.

i.in order to utilize the computer programme for the purposes for which it was supplied, or

ii. to make back up copies purely as a temporary protection against loss, destruction or damage in order only to utilize the computer programme for the purpose for which it was supplied;"

12.6. We have discussed supra the relevant clauses of the End user Agreement and seen what has been precisely transferred to the end users of the software. It clearly emerges that none of the elements of `Copyright' as mentioned in section 14 of the Copyright have been transferred to the end user inasmuch as he cannot do any of the things as set out in clauses (a) (i) to (vi) of section 14, to the extent applicable,nor can he sell or give on commercial rental any copy of the computer program. On the other hand, what has been permitted to him is all that is permissible under section 52 of the Copyright Act, to the extent *applicable, which simply facilitates him to use the software without infringing copyright. This conclusively demonstrates that the end users have paid consideration for the use of a computer software and not copyright of a computer software. As the DTAA treats consideration for the use of copyright of a literary or artistic work, etc. as royalties, there can be no question of including consideration for the use of a literary or artistic work, etc. within the ambit of `Royalties' as per Article 13(3)(a) of the DTAA.*

12.7. There is another dimension of this issue. While going through the Distributors Agreement, we have noted that the assessee has simply purchased shrink-wrapped software or off-the-shelf software from the Corporate. The assessee was not allowed to use the copyright of such software, which obviously vest in the Corporate. Since the assessee itself has not acquired any copyright in the mining software, it cannot resell or transfer anything more than what it has acquired. We, therefore, hold that the consideration received by the assessee for sale of shrink wrapped software cannot be considered as `Royalties' within the meaning of Article 13 of the DTAA as the same is a consideration for sale of a copyrighted product and not use of any copyright.

13.1. Now we take up the contention of the ld. DR that provisions of section 9(1)(vi) should be applied to determine the taxability of the amount. It was contended that as the ld. AR has admitted the amount of sale of software covered under Explanation 4 to section 9(1)(vi), the same should be taxed as such.

13.2. In this regard, we find that sub-section (1) of section 90 of the Act provides that the Central Government may enter into an agreement with the Government of any other country for the granting of relief of tax in respect of income on which tax has been paid in two different tax jurisdictions. Sub-section (2) of section 90 unequivocally provides that where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, ' the provisions of this Act shall apply to the extent they are more beneficial to that assessee'. The crux of sub-section (2) is that where a DTAA has been entered into with another country, then the provisions of the Act shall apply only if they are *more beneficial to the assessee. In simple words, if there is a conflict between the provisions under the Act and the DTAA,the assessee will be subjected to the more beneficial provision out of the two. If the provision of the Act on a particular issue is more beneficial to the assessee vis-a-vis that in the DTAA, then such provision of the Act shall apply and vice versa. The Hon'ble Supreme Court in the case of CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC) has held that the provisions of sections 4 and 5 are subject to the contrary provision, if any, in DTAA. Such provisions of a DTAA shall prevail over the Act and work as an exception to or modification of sections 4 and 5. Similar view has been taken by the Hon'ble Bombay High Court in CIT v. Siemens Aktiongesellschaft (2009) 310 ITR 320 (Bom.). In the light of the above discussion, it becomes vivid that if the provisions of the Treaty are more beneficial to the assessee vis-a-vis its counterpart in the Act, then the assessee shall be entitled to be ruled by the provisions of the Treaty. We have held above that amount from sale of softwarefalls under Article 7 (Business profits) and not under Article 13 (Royalties). Since the position as per the DTAA is more beneficial to the assessee in comparison with that under the Act, in which the receipts admittedly fall under section 9(1)(vi), we hold that the assessee is entitled to exercise option in his favour by choosing to be governed by the DTAA.*

14.1. Be that as it may, we find that there is another aspect of the matter. This is without prejudice to our finding that consideration for sale of software does not fall within the scope of the term `Royalties'. Even if the view point of the AO is accepted for a moment, with which we do not really agree, that such amount falls under para 3(a) of Article 13, in our considered opinion, even then the amount cannot be taxed as `Royalties' because of the operation of para 6 of Article 13, which reads as under : -

> *"6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical*

services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provision of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be,shall apply."

14.2. Para 6 of Article 13, to the extent applicable, states that the provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a

resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein. In simple terms, this means that the amount falling under para 3 of Article 13 cannot be taxed as Royalties under paras 1 and 2, if the beneficial owner of the royalties, being a resident of a Contracting State (UK), carries on business in the other Contracting State (India) in which the royalties arises through a permanent establishment situated therein (India). Once these conditions are satisfied, then the later part of para 6 comes into play, as per which the provision of Article 7 (Business profits) of this Convention shall apply. In other words, on the fulfillment of the conditions in the first part of para 6, the amount shall not be considered as `royalties' under paras 1 and 2 of Article 13, but shall fall for consideration under Article 7 of the DTAA, being, `Business profits'. There is no dispute on the fact that the assessee is a UK company having its branch office in India (which is its permanent establishment) and the transactions in question are sale of computer software made by such permanent establishment to certain parties in India. This shows that all the requisite conditions for the applicability of first part of para 6 of Article 13 are fully satisfied. On such fulfillment, the amount of `royalties' is liable to be considered under Article 7

(Business profits). As the assessee has declared such receipts under Article 7, the view taken by the authorities in this regard, shifting such amount from Article 7 (business profits) to Article 13 (royalties), being contrary to the mandate of the DTAA, is liable to be and is hereby set aside.

15. In the final analysis, we approve the assessee's stand on the sale of computer software as business profits, by jettisoning the Revenue's viewpoint of royalty. This ground is allowed."

19. Thus, from the perusal of the aforesaid decision, it is clear that all the arguments have been duly analysed and addressed by the bench while deciding this issue. The articles of DTAA between India and Netherlands are identically worded. No amendment has been brought out in the DTAA so far. Article 12(4) of DTAA between India and Netherlands defines the term 'Royalty'as under:-

"*4. 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, any copyright of literary, artistic or scientific work, including motion picture films and works on film or video tape for use in connection with television, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*

20. It may be noted from the above said definition that it is identical to the definition given in the Indo UK DTAA. Further, this definition does not include the word 'computer programme' or 'software'. It has been held by the bench after making analysis in detail that the payment is made for the customer for using the software as such and not the 'process' involved in it. It is further noted that since the definition given in Article 12(4) of the DTAA does not contain any consideration for the use or right to use in 'computer programme' or 'software', the same cannot be imported into it. Further, as discussed above also, the perusal of clauses of the Master Agreement demonstrate that the customer, viz. HLL has paid the consideration for '**use of computer software'** and **not** '**copyright of the computer software'**. But, the DTAA treats consideration for the use of copyright of a laboratory or artistic work, etc. as 'Royalty', there can be no question of including consideration for the use of a laboratory or artistic work, etc within the ambit of 'Royalty' defined in Article 12(4) of the DTAA.

21. It was also argued by the Revenue that provisions of section 9(1)(vi) should be applied, and if these are so applied, then the sale of software shall be covered under Explanation 4 to section 9(1)(vi), and, therefore, the same should be brought to tax as such. In this regard also, it is noticed by us that no corresponding amendment has been made in the provisions of the DTAA. Under these circumstances, the assessee would be entitled to the provisions, which are more beneficial to the assessee out of the provisions of Indian Income-tax Act and DTAA between India and the Netherlands, in view of provisions contained in section 90(2) of the Act. We have already held that as per the provisions of India Netherlands DTAA, the amount received by the assessee on account of sale of software would not fall within the definition of 'Royalty' as provided in Article 12(4) of the DTAA. Under these circumstances, it will not be legally permissible for us to refer to the provisions of the Act to decide the taxability of this amount in the hands of the assessee in India. Thus, in our considered view, based upon the facts and circumstances of the case and legal position as discussed above, the impugned amount received by the assessee is in the nature of business profits assessable under Article 7 of India Netherlands DTAA and would not be taxable as 'Royalty' under

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Article 12 of the DTAA. Thus, this ground is decided in favour of the assessee.

22. Grounds 3 & 4: During the course of hearing it was stated that these grounds will become infructuous if Ground 2 is decided in favour of the assessee. Since we have decided Ground 2 in favour of the assessee, Grounds 3 & 4 are dismissed as infructuous at this stage.

23. As a result, appeal of the assessee is partly allowed.

24. Now we shall take up appeal for AY. 1999-2000 in ITA No.84/Mum/2007.

25. Ground 1 relates to reopening of assessment which has not been pressed before us, therefore, dismissed.

26. Ground 2: This ground relates to re-characterization of income received from licensing of software, as "Royalty" as against business income as was claimed by the assessee. This ground is identical to Ground 2 of AY. 1998-99, this has been decided in favour of the assessee. It was submitted that facts as well as legal position are identical in this year as well; therefore, this ground is decided in favour of the assessee, following our order for AY 1998-99.

27. Grounds 3 & 4 are identical to grounds 3 & 4 of A.Y. 1998-99 and in view of our order for A.Y. 1998-99, these grounds are dismissed as infructuous at this stage.

28. As a result, this appeal of the assessee is also partly allowed.

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29. In the result, both the appeals of the assessee are partly allowed.

Order pronounced in the court on this 21st day of December, 2016.

Sd/- Sd/-

(AMIT SHUKLA)	(ASHWANI TANEJA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt: 21st December, 2016

Pk/-

Copy to :
The appellant
The respondent
The CIT(A)
The CIT
The Ld. Departmental Representative for the Revenue, L-Bench
(True copy) By order

ASSTT.REGISTRAR, ITAT, MUMBAI BENCHES

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