Is Income From Software Taxable As “Royalty”?  

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The controversy over the interpretation of the term ‘royalty’ has come to the fore in light of two judgments of the Hon’ble Income Tax Appellate Tribunal in the past year, (1) the common judgment of the Hon’ble Delhi ‘H’ Bench (dated 26th October, 2010) in a set of cases (Gracemac v. ADIT, ITA Nos. 1331-1336/Del/2008, Microsoft Corporation v. ADIT, ITA Nos. 1392/Del/2005, Microsoft Regional Sales Corporation v. ADIT, ITA Nos. 1393-1395/Del/2005, the common judgment is hereinafter referred to as ‘Gracemac’); and (2) the judgment of the Hon’ble Mumbai ‘E’ Bench (dated 26th August, 2011) (ADIT v. TII Team Telecom International, ITA Nos. 3939/Mum/2010, hereinafter referred to as ‘TII Team’). The controversy – brewing now for quite some time – is essentially this: under what circumstances can the payment received for (what is loosely termed as) supply of software/rights in software be taxed as ‘royalty’ under Section 9 of the Income Tax Act, 1961, and under various Double Tax Avoidance Agreements.

Prior to the decision in Gracemac, decisions of the Tribunal (including a decision of the Special Bench) had drawn a distinction between “copyright” and “copyrighted article”; and had taken the view that when what is transferred is merely a “copyrighted article” and not rights in the “copyright” itself, then there is no question of the payment being characterized as royalty. In Gracemac, however, this distinction was doubted; and the Tribunal in Gracemac also cast some doubt over the extent to which a narrower definition of ‘royalty’ in a treaty would prevail over a subsequent retrospective definition of ‘royalty’ in the Income Tax Act. In TII Team, on the other hand, the Hon’ble Mumbai Bench has reaffirmed the distinction between “copyright” and “copyrighted article”, and has also reaffirmed the principle that the definition in a treaty would override the definition in the Act. Thus, the Mumbai Bench has refused to follow the decision of the coordinate Bench in Gracemac. An attempt is made in this article to humbly try to analyse these two conflicting decisions. The author respectfully submits that the view of the Mumbai Bench is the preferable one to take, and that the distinction between “copyright” and “copyrighted article” has a strong basis in law. Accordingly, in the first section of this article, the author proposes to examine how this distinction came to be applied in tax laws. In the second and third part, the decisions of the Tribunal in Gracemac and TII Team respectively will be discussed.

A. Background: The Distinction between “Copyright” and “Copyrighted Article”

Before looking at the reason why the distinction between “copyright” and “copyrighted article” is relevant, it is convenient to set out the relevant part of Section 9 of the Act, which defines “royalty”. Explanation II to Section 9(1)(vi) states:

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;
(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 (v)

Thus, it will be seen that which sub-clauses (i) and (iii) also refer to various forms of intellectual property, a specific provision in respect of copyright is made under clause (v). (It may be contended that payment for software is payment in respect of a process – this argument is specifically addressed in detail in TII Team discussed below.) Under clause (v) of the Explanatory, for a payment to be properly characterized as “royalty”, it must be for the transfer of “all or any rights” in respect of “any copyright”. Now, if one goes to a book-store and buys a book (a work which enjoys copyright protection), can it fairly be said that the money one pays to the shop-owner is for the transfer of all or any rights in respect of a copyright? Or is it merely a payment for using the particular copy of the book (i.e., the copy of the copyrighted article)? Clearly, just because I have bought the book does not mean that I can freely make copies and distribute or sell those copies of the book commercially. My rights are limited to the copy of the book which I have bought. Can it then be said that I have acquired any rights in the copyright itself? For answering this question, it is essential to briefly look at the definition of “copyright”, which is contained in the Copyright Act, 1957. Section 14 of the Copyright Act, 1957 states:

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 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

Thus, from the above, it will be seen that for a transfer of a right in respect of a copyright, one or more of the above rights must be transferred. When one buys a book from a bookstore, none of the rights in respect of the copyright itself are transferred. For instance, on buying a book, one does not obtain any exclusive right to reproduce, make copies, translations or any of these.

Is the position any different when one buys a software product which is embedded in a CD? For instance, when one goes to a computer store and “buys” off-the-shelf a copy of an anti-virus programme on a CD, one is really “buying” the disc. On loading the disc, one would typically have to agree with a non-exclusive end-user license agreement. In such a scenario, one does not obtain any exclusive right to sell or offer the anti-virus programme on commercial rentals, nor does one obtain any exclusive right listed under clause (a) of Section 14 of the Copyright Act. In such a case, the payment is in respect of a copyrighted article; not in respect of a copyright. Of course, finally, what the payment is for would depend on the specific agreement between the parties. At times, if the agreement is for purchase of specifically customized software, it may be possible that one of the exclusive rights referred to in Section 14 is also obtained.

It may not be out of place here to mention that the Supreme Court has had the occasion to examine the nature of software in a slightly different context, when it was called on (in Tata Consultancy Services v. State of Andhra Pradesh, 271 ITR 401, hereinafter referred to as ‘TCS v. AP’) to decide whether branded software amounts to “goods” for the purposes of sales tax legislation. The Court, in the course of examining this question, referred to several American judgments and stated, “It has been held that by sale of the software programme the incorporeal right to the software is not transferred. It is held that the incorporeal right to software is the copyright which remains with the originator. What is sold is a copy of the software. It is held that the original copyright version is not the one which operates the computer of the customer but the physical copy of that software which has been transferred to the buyer. It has been held that when one buys a copy of a copyrighted novel in a bookstore or recording of a copyrighted song in a record store, one only acquires ownership of that particular copy of the novel or song but not the intellectual property in the novel or song... A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax....”

Unquestionably, intellectual property may have been embedded in, and added value to, the “goods”; this does not mean that the intellectual property itself is transferred. In the income
tax context, the argument that “copyright” and “copyrighted article” are one and the same, was raised by the Revenue in the case of Motorola v. DCIT (2005) 96 TTJ Delhi 1 (SB) (hereinafter referred to as ‘Motorola’). The assessee, relying on Lucent Technologies v. ITO 82 TTJ 163, contended that while one cannot have a copyright without a copyrighted article, one can certainly have a copyrighted article without a copyright. The Hon’ble Special Bench specifically noted, “We may now briefly deal with the objections of Mr. G.C. Sharma, the learned senior counsel for the Department. He contended that if a person owns a copyrighted article then he automatically has a right over the copyright also. With respect, this objection does not appear to us to be correct... we hold that the software supplied was a copyrighted article and not a copyright right, and the payment received by the assessee in respect of the software cannot be considered as royalty either under the Income-tax Act or the DTAA...” Thus, the Special Bench expressly rejected the argument that copyright and copyrighted article are one and the same. Without labouring the point too much, it will suffice to say that following this Special Bench, until the decision in Microsoft, different Benches accepted the view that there is a distinction between “copyright” and “copyrighted article”; and a payment to be “royalty” must be in respect of the former and not the latter. Reference may be made to DCIT v. Metopath Software Intl. (2006) 9 SOT 305, Sonata Information Technology v. ACIT (2006) 6 SOT 700, Velankani Mauritius v. DDIT ITA No. 985/Bang/2009, Kansai Nerolac Paints v. ADIT I.T.A. No.568/Mum/2009 etc. In this background, until the decision in Gracemac, the distinction between “copyright” and “copyrighted article” became entrenched in the law. We can now look at the decision in Gracemac to see why this accepted principle was not applied by the Hon’ble Tribunal.

B. The decision in Gracemac

As stated earlier, Gracemac was a common judgment in three connected appeals, of three different assesses. These three assesses were Microsoft, Gracemac, and Microsoft Regional Sales Corp. The case of Gracemac (ITA Nos. 1331-1336/Del/2008) was taken as the lead matter by the Tribunal. Briefly, the facts as recorded by the Hon’ble Bench in paras 3 to 5 of the common order are as under:

“3. Microsoft Corporation (MS Corp) in its return filed for AY 1996-97 offered its income from licensing of software to Original Equipment Manufacturers (OEM) to tax and did not offer to tax its income from sale of Microsoft software products to Indian Distributors. The assessing officer, however, taxed the payments received from Indian Distributors as ‘royalty’ under section 9(1)(vi) of Income Tax Act, 1961 and Indo-US DTAA. Against the said order MS Corp filed appeal before CIT(A) and while passing an order CIT(A) also confirmed the addition made to the income of MS Corp. Against this order assessee is in appeal before this Tribunal.

4. For AY 1999-00 to 2001-02 in case of MRSC, the payments received from Indian distributors on sale of Microsoft software products were not offered to tax as royalty. However, the assessing officer assessed the entire payments in the hands of MRSC as royalty income on the ground that payments have been received towards licensing of Microsoft software products which amounts to grant of right in Intellectual property Rights (IPRs). On appeal against the order of assessing officer, ld CIT(A) has considered that the software is being licensed and not sold and accordingly
the consideration received for supply of software should be taxed as royalty. Against this order the assessee is in appeal before this Tribunal.

5. In case of Gracemac for assessment years 1999-2000 to 2004-05, the assessing officer had taxed the payments made by MO Singapore to Gracemac, USA @ 35%/40% of net sales consideration received by MRSC from Indian distributors in India under Section 9(1)(vi)(c) of the Act and Article 12(7) (b) of the Indo- US Double Taxation Avoidance Agreement (DTAA) on the ground that Gracemac’s source of royalty is MO which distributes Microsoft software products in India through MRSC and accordingly, Gracemac is getting royalty out of the licensing of Microsoft software products carried out in India. The assessing officer also held that the royalty received from MO is taxable under Article 12(7)(b) of the India US DTAA as the payment to Gracemac is based on the number of users of intellectual property rights in India. Ld CIT(A), however enhanced the assessment by bringing the entire consideration received by MRSC from Indian distributors on the contention that MRSC and MO are legal façade. To this extent, the same revenue is being taxed in case of MRSC and Gracemac for the Assessment Years 1999-00 to 2000-01 and this according to assessee has resulted in double taxation for these Assessment Years.”

Gracemac’s case was taken as the lead matter; and the Tribunal noted (in para 7) that the issue in all the cases was whether supply of off-the-shelf software by non-resident companies to Indian distributors is taxable in the hands of the non-resident companies as “royalty” u/s 9(1)(vi) of the Act and under Article 12 of the India-US DTAA. What was in issue was the payments made by the distributors to the non-resident companies. The business model used by Microsoft in these cases (particularly in the case of Gracemac) was that on 1/1/1999, Microsoft Corporation entered into an agreement with Gracemac (100% subsidiary of Microsoft) which granted Gracemac an exclusive license to manufacture and distribute MS software in accordance with the terms of the license. It was agreed that Gracemac would make no copies except as provided in the agreement, and the master-copy of the software would always be the property of Microsoft and would be returned to Microsoft on termination of the agreement. Gracemac in turn granted a non-exclusive license to Microsoft Operations (“MO Singapore”) to reproduce the software and distribute the same to retailers/distributors or to Microsoft subsidiaries. MO paid Gracemac royalty calculated as a percentage of the price received from the distributors. MO in turn entered into a non-exclusive distribution agreement with MSRC. Under this, MO sold the copies to MSCR in Singapore, and MSRC further distributed the same to local distributors, who had the right to distribute the software in their respective countries. The distributor sold the products to Indian distributors, who in turn sold the same to end-users. Microsoft Corporation (the parent), the owner of the relevant intellectual property, entered into an end-user license agreements (EULAs) with the end-users. Thus, the copies of the software were purchased by the end-users, who also entered into EULAs with Mocrosoft Corporation. The end-user was never granted any right to make additional copies for commercial use. Before the AO, there was no dispute that the payment made by MO to Gracemac was in the nature of royalty, but the assessee contended that the same was not chargeable under the India-US treaty (as they were not royalty from an Indian source and were outside the scope of taxability under the treaty). The assessing officer however took the view that the payment made by the Indian
end-user itself was in the nature of royalty. As the source of the royalty on that view was the Indian end-user, the AO held that the sums would be taxable in India. The Tribunal pointed out (in para 76) that “In the cases before us the taxation of payments made by end users for computer programme in the form of ‘shrink wrapped’ software through a distribution channel is involved.” It then turned to the thrust of the assessee’s submissions that there is a distinction between “copyright” and “copyrighted article”.

The Bench noted that the expression “copyrighted article” is not defined anywhere in Indian law, and the decision of the Special Bench in Motorola had relied on American decisions and on OECD commentary to introduce this distinction. The Tribunal then purported to rely on the judgment of the Supreme Court in CIT v. P.V. Kulandagan Chettiar (2004) 137 Taxman 460 (SC) for the proposition that OECD commentary would not be a safe guide for interpreting provisions of the Income Tax Act. It is humbly submitted that it was not open to the Tribunal to examine the reasoning of the Special Bench in Motorola. It is one thing to say that the regular Bench of the Tribunal can interpret a Special bench judgment to find out the true ratio of that case, but it is quite another thing to say that it is open for the regular Bench to comment on the reasoning adopted by the Special Bench. Thus, once the Special Bench accepted that there is a distinction between “copyright” and “copyrighted article”, it was not open to the regular Bench to take the view that the said distinction does not find an existence in Indian law. Further, it may not be correct to say that the OECD commentary has no relevance whatsoever in interpreting the relevant provisions of law. The assessee never contended that the OECD commentary were conclusive on the point; as persuasive authority, however, the OECD commentary can certainly be relied on in appropriate cases. The decision of the Supreme Court in Chettiar’s case cannot be seen as an absolute bar against this practice. Indeed, the Supreme Court itself has relied on the OECD commentary: reference may be made to Azadi Bachao Andolan v. Union of India 263 ITR 706 (hereinafter “Azadi Bachao Andolan”), where the OECD commentary was relied on in support of the views of the Bench on the concept of “fiscal residence”.

Next, the Hon’ble Bench dealt with the judgment of the Supreme Court in TCS v. AP, and it held that the decision in TCS which was delivered in the context of sales tax proceedings, would not be of relevance in deciding the meaning of “royalty” in income tax proceedings. The Bench then referred to the EULA entered into between Microsoft Corp and the end-user, according to which, Microsoft products have been licensed and not sold. The Tribunal stated that “conditions of End User Licence Agreement itself proves that the software is licenced and not sold. This fact is further buttressed by the wordings of clause 19 of EULA which states that ‘the product is protected by copyright and other intellectual property laws and treaties. Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product. The product is licensed and not sold.’” While this may be true, it must be noted that the payment made by the users was in respect of the copyrighted article, while the EULA is typically entered into for protection of the copyright. Thus, if the Bench had accepted the distinction between “copyright” and “copyrighted article”, this language of the EULA would not have been relevant. This is where the judgment in TCS v. AP assumes importance: the Supreme Court has clarified that when an off-the-shelf software product is purchased, it must be held that there is a sale of goods and the payments taxable under sales tax laws
would be the payments made for purchase of the CD. This clarifies that the payment is with respect to the copyrighted article itself. The Bench in *Gracemac* observed (in para 99), “it is clear that the end users have not purchased copy of software products on electronic media as contended by the assessee but a licence to use such software products.” It is submitted that this statement requires reconsideration: just because there is a EULA which grants a license to use software does not mean that the payment made is not for purchase of the license: as the Supreme Court has clarified, the purchase is of the copy of the software on the electronic media. The product or goods purchased, for which payment is made, is the CD. The value of the CD may be derived from the fact that there is a copyright-protected software: this does not, however, change the fact that what is purchased in the CD and not the copyright itself. For instance, let us assume that a company develops a new type of pencil, and obtains a patent for the same. One might pay a higher sum for such new type of pencil, and this higher value may be entirely derived from the patent-protected idea embodied in the pencil. This does not change the fact that the payment is made for the pencil itself, i.e. the article itself, and not for any right in respect of a patent. The contrary view would lead to almost all payments being royalty: in today’s world, it is hard to think of any product which does not derive value from some form of intellectual property. It is respectfully submitted that the Hon’ble Tribunal in *Gracemac* has not offered a completely convincing explanation for discarding the distinction between copyright and copyrighted article, and for distinguishing the decision in *TCS*. In this connection, it may also be relevant to note that this very issue of the applicability of *TCS* was considered by the Bangalore Bench in *Velankani Mauritius*. The Hon’ble Bangalore Bench had held that the decision in TCS assumed relevance even in this context because the Supreme Court had held that the transfer of a CD would result in a sale of goods, and (reasoned the Bangalore Bench) once there is an outright sale, there cannot be any question of royalty. (In *Sonata* also, the decision in *TCS* has been applied in this context.) Unfortunately, in *Gracemac*, the Hon’ble Bench has not considered this decision of a coordinate Bench in *Velankani Mauritius*.

The Tribunal also referred to several suits filed by Microsoft Corporation in the Delhi High Court in respect of alleged copyright infringement where the defendants (end-users) had indulged in multiple unlicensed usage of the software. The Tribunal held (see para 102) “At one hand the assessee is contending that the Microsoft products sold to the end users are copyrighted articles are products and do not contain copyright. On the other hand, under Copyright Act they are enforcing their rights stating that the use of unlicenced/pirated copy of software products involves infringement of copyrights. The assessee is thus blowing hot and cold in the same breath on the same issue. When payment of tax is concerned, it is sale of "copyrighted" article and not a licence, but when question of infringement comes, plaints are filed before Hon’ble Delhi High Court claiming that the end users have indulged in use of unlicenced/pirated products.” With respect, it is submitted that the assessee was not in fact blowing hot and cold in the same breath. Just because a suit for copyright infringement is commenced, this does not mean that that the products sold are “copyrights”. Nowhere did the assessee contend that the copyrighted articles did not derive value from the copyright: what was contended was that no copyright was transferred. Section 51 of the Copyright Act deals with infringement of copyright. In sum, when a third party does anything, the exclusive right to do which is conferred by the Act on the owner of the copyright, then he is said to
have infringed the copyright. A license is typically something which makes legal an act which otherwise would have been illegal. Thus, when copies are made in violation of the EULA, this (making of the copies) is an act which infringes copyright. Bringing a suit for copyright infringement does not at all mean that the plaintiff accepts that the payment made by the end-user is for transfer of rights in the copyright itself. It is not clear why the Bench thought that Microsoft was “blowing hot and cold in the same breath”.

Finally, on the issue of whether the assessee was entitled to benefits under the India-US DTAA, the Tribunal ruled against the assessee again. (The issues in connection with the inter-relationship between treaties and domestic laws are discussed by Senior Advocate Shri S.E. Dastur in his article titled “Principles of Interpretation of issues in Double Taxation Avoidance Treaties” which can be accessed at http://www.itatonline.org/interpretation/interpretation17.php). The Tribunal noted that there is no difference in the definition of royalty between the India-US Treaty and hence, the assessee cannot get any benefit under the treaty. However, despite holding so, the tribunal went on to say that even if there was a conflict, the definition in the Act would prevail over the definition is the treaty. The Tribunal effectively held that in such a case, the Explanation to Section 9(1) inserted by the Finance Act 2007 with retrospective effect from 1976 would prevail over the Indo-US treaty, on the principle that the later legislation would prevail over the earlier treaty. In support of this proposition, the Tribunal relied on Gramophone Company v. V.B. Pandey, AIR 1984 SC 667 (hereinafter referred to as “Gramophone Company”). In this decision, however, there was no enabling provision such as Section 90 of the Act (the issue was whether an international convention which is not part of domestic law can prevail over the domestic legislation). As such, the reliance on Gramophone Company appears to require some reconsideration.

Thus, the Tribunal in Gracemac took a view contrary to that expressed by several other Benches, including the Special Bench, rejected the distinction between “copyright” and “copyrighted article”, and held that the payment made by end-users was in the nature of royalty. Thus, it will be seen that the decision in Gracemac raises new questions and increases uncertainties in the legal position. In this situation, the Mumbai Bench in TII Team had the occasion to clarify the law in this regard, and this decision can now be looked at.

C. TII Team: Clarity on the Legal position

In TII Team, the Mumbai Bench had the opportunity to consider in detail the decision of the Delhi Bench in Gracemac. The Revenue submitted that Gracemac being the later decision on the point, should be followed in preference to the other judgment on the issue. In this case, the assessee was entitled to the benefits of the Indo-Israel DTAA; and the issue arose as to whether the payment for supply of software would be royalty under the treaty. On the issue of whether the treaty provisions would prevail over the Act, the Tribunal firmly took the view that notwithstanding Gracemac, the treaty provisions would prevail. The decision in Gramophone Company was distinguished. The Mumbai Bench noted that the observations which had been relied on in Gracemac were actually “in a situation in which an international
convention and a bilateral treaty was being given effect to without there being any enabling provisions for such convention and treaty overriding the domestic legislation.” Thus, it was clearly stated that the decision in Gramophone Company can have no application to the Income Tax Act, where a specific overriding measure is introduced through Section 90. Further, the Tribunal also noted that in Gracemac, the actual decision proceeded on the basis that there is no difference between the treaty provision and the Act, and hence, the coordinate bench observations in relation to application of the treaty were only obiter dicta. The Mumbai Bench instead preferred to follow the clear language of Section 90 of the Act and the decision of the Supreme Court in Azadi Bachao Andolan, which has settled the issue in the assessee’s favour.

Next, the Hon’ble Bench turned to the issue of whether the payments were in the nature of royalty or not. The term “royalties” is defined in Article 12(3) of the India-Israel DTAA as follows:

“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 cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.”

The Bench held that the issue was covered in favour of the assessee, and was no longer debatable, in view of the decision of the Special bench in Motorola. Further, it explained the law in the following sentences, “Copyright is one thing, and copyrighted article is quite another thing... To give a simple example, when a person is using a music compact disc, that person is using the copyrighted article, i.e. the product itself, and not the copyright in that product. As held by the Special bench, in Motorola’s case (supra), the four rights which, if acquired by the transferee, constitute him the owner of a copyright right, and these rights are: (i) The right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending. (ii) The right to prepare derivative computer programmes based upon the copyrighted computer programme. (iii) The right to make a public performance of the computer programme. (iv)The right to publicly display the computer programme.”

It was then noticed that the decision in Gracemac was based on the wordings of Section 9 of the Act; but the wordings in the India-Israel treaty were different. In the definition in the treaty, the word “of” was present between ‘copyright’ and ‘literary’ (“any copyright of literary, artistic...”) Thus, the distinction in Gracemac was distinguished. However, it is important to note that not only has the Mumbai Bench distinguished Gracemac (perhaps because being a coordinate Bench, it could not express complete disagreement), but also the discussion in the decision provides an extremely strong counter-rationale to the points which weighed with the Bench in Gracemac. To that extent, it can safely be said that the decision in TII Team clarifies the position even as a general matter. Much of the compelling logic in TII Team is based on the conceptual distinction between “copyright” and “copyrighted article”. For instance, in dealing with the issue of whether the payment can be considered as payment
for a process, the Tribunal notes that the relevant question to ask is not whether the software is a “process” or not. Instead, the more relevant question would be, “what is it that a customer pays for?” Thus (refer to para 17), “it is akin to a situation in which a person hires a vehicle, and the question could be as to what does he pay for – for the use of the technical knowhow on the basis of which vehicle operates, or for the use of a product which carries passengers or goods from one place to another. The answer is obvious. When you pay for use of vehicle, you actually pay for a product which carries the passengers or goods from one place to another and not the technical knowhow on the basis of which such a product operates. Same is the case with the software, when someone pays for the software, he actually pays for a product which gives certain results, and not the process of execution of instructions embedded therein.”

In support of this, the Tribunal also relied on the decision of the Delhi High Court in Asia Satellite v. DIT 332 ITR 340.

Accordingly, the Tribunal in TII Team came to a conclusion different from that reached in Gracemac, giving strong reasons for the same.

D. Conclusion

From the above, it will be seen that the issue of whether payment of the above nature are royalty or not, is an issue which continues to present difficulties. While the issue appeared settled after the decision of the Special Bench in Motorola, the decision of the Delhi Bench in Gracemac attempted to reopen the same controversy. It is respectfully submitted that the decision in Gracemac requires reconsideration, and being contrary to the clear decision of the Special Bench and several coordinate benches in this regard, is not binding judicial precedent. It needs to be seen in the facts of the particular case as to what exactly the payment is for: whether it is for copyright itself, or only for copyrighted article. Typically, in the case of an off-the-shelf purchase, the payment would be for the article, and not for the exploitation of the copyright as such. It is humbly submitted that the better approach to take would be that which was adopted by the Mumbai Bench in TII Team. Although in TII Team, the decision proceeded on the basis of the specific wording of the India-Israel treaty, it is respectfully submitted that the propositions laid down therein are of general application also. The Tribunal has placed the distinction between “copyright” and “copyrighted article” on a strong conceptual foundation. It has explained how such payments cannot be seen as payments in respect of “process”. It has also reaffirmed the sanctity of the Special bench decision, and has clarified that the decision in Gracemac being contrary to the law laid down by the Special Bench cannot be followed. It is hoped that the same view would be taken by the High Courts when the matter is carried in appeal.

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