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

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER AND SHRI VIVEK VARMA, JUDICIAL MEMBER

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ITA Numbers

837/M/07, 5076/M/08, 5077/M/08, 5078/M/08, 5079/M/08 5080/M/08, 5081/M/08, 5082/M/08, 5083/M/08, 5084/M/08 5085/M/08, 5086/M/08, 5087/M/08, 5088/M/08, 5089/M/08, 5090/M/08, 5091/M/08, 5092/M/08, 5467/M/08, 5469/M/08, 5470/M/08, 5474/M/08, 5475/M/08, 5476/M/08, 5477/M/08, 6093/M/08, 3431/M/08, 3432/M/08, 3433/M/08, 3434/M/08, 3435/M/08, 3436/M/08, 3437/M/08, 3438/M/08, 3439/M/08, 3440/M/08, 3441/M/08, 3442/M/08, 3443/M/08, 3444/M/08, 4278/M/08, 4279/M/08, 4280/M/08, 4281/M/08, 4282/M/08, 4283/M/08, 4284/M/08, 4285/M/08, 4286/M/08, 4287/M/08, 4244/M/08, 4245/M/08, 4246/M/08, 4247/M/08, 4248/M/08, 4249/M/08, 4250/M/08, 4251/M/08, 4252/M/08, 4253/M/08, 4254/M/08, 4255/M/08, 4256/M/08, 4257/M/08, 4258/M/08, 4259/M/08, 4260/M/08, 4261/M/08, 4291/M/08, 4305/M/08, 4306/M/08, 4307/M/08, 4308/M/08, 4309/M/08, 4310/M/08, 4873/M/07, 4874/M/07, 4875/M/07, 4876/M/07, 4877/M/07, 4878/M/07, 4899/M/07, 4900/M/07, 4901/M/07, 4902/M/07, 4903/M/07, 4904/M/07, 4905/M/07, 4906/M/07, 4907/M/07, 4908/M/07, 4909/M/07, 4910/M/07, 4916/M/07, 4917/M/07, 4918/M/07, 4919/M/07, 4920/M/07, 4921/M/07, 4922/M/07, 4923/M/07 , 4924/M/07, 4925/M/07, 4926/M/07, 4927/M/07, 4928/M/07, 5373/M/07, 5374/M/08, 4672/M/07, 4673/M/07, 4674/M/07, 4675/M/07, 4676/M/07, 4677/M/07, 5071/M/08, 5072/M/08, 5073/M/08, 5074/M/08, 5075/M/08. (119 appeals)

Sr.No.	Appellant	Respondent
1	DDIT(IT)-2(1) R.No.120, 1st Floor Scindia House, Ballard Estate, N.M. Road, Mumbai-400 038.	M/s. Reliance Infocom Ltd. (Now known as, **Reliance Communications Ltd**) , C-Block, 1st Floor, Dhirubhai Ambani Knowledge City, Koperkhairne Navi Mumbai-400 710. **PAN-AAACR265**

ITA Nos.
5468/M/08, 5471/M/08, 5472/M/08,
5473/M/08, 729/M/09, 4501/M/09.

Sr.No.	Appellant	Respondent
2	DDIT(IT)-2(1) R.No.120, 1st Floor Scindia House, Ballard Estate, N.M. Road, Mumbai-400 038.	Reliance Communications Infrastructure Ltd

ITA. No.730/Mum/09.

Sr.No.	Appellant	Respondent
3	DDIT(IT)-2(1) R.No.120, 1st Floor Scindia House, Ballard Estate, N.M. Road, Mumbai-400 038.	Reliance Infostream Private Limited (Now Reliance BPO Limited)

ITA Nos.
5093/M/08, 5094/M/08, 5095/M/08, 5096/M/08

Sr.No.	Appellant	Respondent
4	DDIT(IT)-2(1) R.No.120, 1st Floor Scindia House, Ballard Estate, N.M. Road, Mumbai-400 038.	Reliance Telecom Ltd.

ITA Nos.
7001/M/10, 7002/M/10, 7003/M/10, 7004/M/10
For Asst. Years 2003-04, 2004-05, 2005-06 & 2007-08.

Sr.No.	Appellant	Respondent
5	Addl. DIT (International Taxation), Range-4, Mumbai	M/s. Lucent Technologies GRL LLC, USA

Revenue by	:	Shri Parag Vyas
Reliance by Lucent by	: :	Shri J.D. Mistri Shri P. J Pardiwala

Date of conclusion of hearing	:	28/06/2013
Date of Pronouncement	:	06/09/2013

O R D E R

Per Bench

This bunch of appeals is by Revenue against various companies of Reliance (ADAG) group, hereinafter referred as “Reliance” for the sake of convenience, which include Reliance Communications Ltd., Reliance Telecom Ltd. Reliance BPO Ltd., Reliance Communications Infrastructure Ltd. The last four in the group listed above are appeals by M/s. Lucent Technologies GRL LLC, USA (referred as Lucent) against Revenue. In the course of hearing the learned CIT-DR requested for clubbing the four appeals of M/s Lucent as they are interrelated. In the Revenue appeals issue is whether the payments made for acquiring software from No- resident companies is taxable under the provisions of IT Act. The same issue is also in the Lucent appeals. In addition issue of PE, tax credit and levy of interest were other issues in Lucent appeals. Since common issues are involved in these appeals they are heard together.

2. Briefly stated, Reliance Infocomm Ltd., now known as Reliance Communications Ltd. wanted to establish wireless telecommunications network in India. As a part of that it has entered into a Wireless Network General Terms and Conditions contract and Wireless Software contract dated 31.07.2002 with Lucent Technologies Hindustan Pvt. Ltd. (LTHPL), an Indian company of M/s. Lucent group, USA. Wireless software Assignment and Assumption agreement dated 05.08.2002 with LTHPL and Lucent Technologies GRL LLC (LTGL) USA towards supply of software required for telecom network. When Reliance placed first supply orders for software for

an amount of US$11,06,56,855, it made applications under section 195(2) before DDIT-2(1) Mumbai requesting payment for purchase of software without deduction of tax at source. It was Reliance's contention that it was for purchase of software and LTGL has no PE in India and as per DTAA between India and USA, the amount paid is not taxable in India. AO after examining the details of agreements held that the assessee was getting only license to use the software and is in the nature of royalty, taxable at 20% in India under the provisions of Income tax Act 1961. Not only in the case of Lucent, Reliance also similarly placed orders with various other suppliers of telecom software in other countries and sought no deduction certificates on similar contentions. AO passed similar orders in all the cases where Reliance was to remit the monies over a period of time. After deducting tax as directed by the AO, Reliance however preferred appeals before the Ld.CIT(A) as per the then existing provisions of section 248 of the IT Act. The learned CIT(A), vide his orders, held that the amounts paid cannot be considered as royalty as Reliance purchased 'goods' which is a copyrighted article and so, since the seller do not have PE in India the amount is not taxable. Accordingly, he gave relief to Reliance. The Revenue is aggrieved on these orders. The lead order of the AO and CIT(A) pertains to ITA No. 837/Mum/2007 in which the AO' order under section 195(2) dated 12.03.2003 was considered by the CIT(A) in his appeal No. CITA XXXI/DDIT (IT) 2(1)/IT – 448/02-03/06-07 dated 26.10.2006. It was admitted that the facts are more or less similar to the above appeal and main arguments were rendered in this appeal.

3. Since main agreement was with M/s. LTHPL, India and software was supplied by M/s. Lucent USA, the AO initiated proceedings under section 147 to tax the amounts and the orders were passed holding that the amounts are taxable in India. This order was passed, commonly for four assessment years, which was approved by the DRP as per the provisions of section 144C(13) of the I.T. Act. Therefore, Lucent preferred direct appeals to ITAT on these orders of AO.

4. Revenue was represented by Shri Parag Vyas, Special Council and Reliance was represented by Sr. Counsel Shri J.D. Mistry whereas Lucent was represented by Sr. Counsel Sri. P.J. Pardiwala. Revenue has placed various agreements from page No. 1 to 1697 and case law from 1968 to 2129 in three volumes. Reliance also placed relevant documents on record. Lucent has placed a volume containing pages 1 to 622. The cases were heard over a period of time and various clarifications sought were also placed on record.

5. For the sake of convenience, the appeal in ITA No. 837/Mum/2007 and Lucent's appeals were dealt with in detail. The arguments and findings are *mutatis mutandis* apply to other cases also, which will be dealt with later.

ITA No. 837/Mum/2007

6. In this Revenue appeal, Revenue has raised the following grounds: -

"1. On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in deciding that the Assessing Officer was not justified in directing to deduct Tax at Source u/s. 195 of the I.T. Act.

2. On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in holding that no income accrues to M/s. Lucent Technologies GRL LLC in India against the payment of US$ 11,06,56,855/- for the supply of software for use in the Reliance Telecom Network.

3. On the facts and in the circumstances of the case and in law, the ld. CIT(A) failed to appreciate that the payment for obtaining computer software is in the nature of 'Royalty' as defined by the DTAA and liable for taxation in India."

7. Reliance Infocomm Limited, (Respondent), now known as Reliance communications Ltd had entered into a Wireless Software Contract and Wireless Network General Terms and conditions Contract (GTC) dated 31.07.2002 with Lucent technologies Hindustan Private Ltd (LTHPL) and another Wireless Software Assignment and Assumption Agreement dated 05.08.2002 with LTHPL and Lucent Technologies GRL LLC (LTGL), USA for purchase of certain software for the purposes of operation of wireless telecommunication network. Initially, Reliance placed seven purchase orders

of total amount of US$ 11,06,56,855/-. The Reliance filed a applications u/s.195(2) before the DDIT(IT)-2(1), Mumbai (AO) requesting for payment for purchase of software without deduction of tax at source u/s.195. The AO did not allow the petition and held that the tax has to be deducted at source. The Reliance has mentioned that LTGL is a company resident in USA and does not have any PE in India. Therefore provisions of the Double Taxation Avoidance Agreement between India and USA (DTAA) would be available to LTGL, since section 90(2) provides that the provisions of Income-tax Act would apply only if they are more beneficial to LTGL and has relied upon the decision of Hon'ble Supreme Court in the case of Azadi Bachao Andolan & Another (2003) 263 ITR 706. The AO has rejected the claim and has given various reasons for rejection.

8. The AO examined para-15.l of the Wireless Software Assignment and Assumption Agreement and para-3.1 of the same agreement and held that the Reliance was getting only license to use the software and no other title or interest in the software is being transferred to the Reliance. The Reliance had claimed that the license in perpetuity amounts to sale. The AO rejected it and held that the license remains only a license, irrespective of the period involved and further in this fast paced technological progress, rate of obsolescence in software is very high and therefore life of software is limited. The title and proprietary rights would remain with LTGL and the Reliance would not be the owner of the software but would, be only a licensee for the use of or the right to use of the copyright. The AO thereafter examined the provisions of Income-tax Act and held after examining the copyright act and section 9(1)(vi) that licensing, is 'only merely for the use of software and therefore payment made for the license to use software amounts to royalty within the meaning of section 9(1)(vi).

9. The AO also held that the software can be termed as patent or invention and also scientific work and therefore payment for the use of software would be covered under these categories also as per section 9(1)(vi). The AO also held that software can be, termed a secret formula or process. The AO further referred to the circular of Government of Singapore

exempting shrink-wrap software from withholding tax as per Circular 29.12.2000. The AO referred to the US IRS Ruling and held that the payment for software even for a fixed or unlimited period would constitute royalty. The AO referred to the ruling of Australian Court wherein it was held that the amount received in respect of computer software would not be royalty if it does not give any rights in the copyright. The AO held that the software is an intellectual property and falls in the category of copyrights, patents, designs, trade marks, formula, process, commercial/scientific knowledge and therefore consideration received for the license to use the software would constitute royalty. The AO thereafter referred to definition, of royalty in Article-12(3) of the DTAA and held that that payment for the license of software, would also amounts to royalty within the provisions of DTAA. The AO also relied upon the decision of AAR's ruling in the case of ABC Vs. RE (154 CTR 2.46). The AO relied upon the decision of Hon'ble Calcutta High Court in the case of Leonhardt Andra Und Partner, Gmbh 249 ITR 418. The AO also relied upon the decision of Hon'ble AAR in P.No.30/1999 reported in 238 ITR 296. The AO held that the payment for purchase of software amounts to royalty within the meaning of section 9(1)(vi) of the LT. Act and Article-12(3) of the DTAA. He accordingly directed Reliance to deduct tax at 20% as Royalty. After deducting tax, Reliance appealed to Ld CIT(A).

10. Learned CIT(A), vide his order, has considered the issues as under:

> *2.14 I have carefully considered the arguments of the AR and I have also perused the records and gone through the arguments of the A0. It is seen that in the order u/s. 195(2), facts brought out are very scanty. The nature of the transactions and the purposes of acquisition of software has not been examined. The appellant was accordingly required to file copy of agreements, details of purchase bills, purposes of the software acquisition and the role of use of software with the hardware acquired. It is seen that LTHPL had entered into a Wireless Equipment Contract with the appellant dated 31.07.2002 for the supply of wireless equipment. Wireless Software Contract was entered into between LTHPL and the appellant on 31.07.2002 for the supply of wireless software. Wireless Services contract was entered into between LTHPL and the appellant on 31.07.2002 for the services in relation to Wireless Hardware Contract. Wireless Network General Terms and Conditions Contract was entered into between LTHPL and the appellant on 31.07.2002, which is*

applicable to the Software Contract and the licensing of software to the appellant. Wireless Software Assignment and Assumption Agreement (Assignment Contract) was entered into between the appellant and LTHPL (assignor) on one side and LTGL(assignee) on the other side. As per this contract LTHPL had transferred or assigned to LTGL the Software Contract alongwith all rights and entitlement. Section 1 & 2 of this Contract read as under:

"Section 1. Asignment and Assumption. Assignor hereby transfers and assigns to the Assignee (i) the Software Contract, together with all rights, entitlements, covenants and obligations of the Assignor under the Software Contract, including but not limited to the supply and delivery of Software to the Purchaser, and (ii) all rights, entitlements, covenants and obligations of the Assignor under Section 15 of the General Terms and Conditions, relating to Software. Assignee hereby assumes, and, agrees with all of the parties hereto, to perform, observe and be bound by each and all of the foregoing obligations and covenants of Assignor. Notwithstanding the foregoing assignment and assumption, as between Assignor and Purchaser, the parties agree that Assignor shall observe and perform and shall continue, to be bound by all of the terms and conditions of the Software Contract and all of the terms and conditions of Section 15 of the General Terms and Conditions and shall remain fully liable to Purchaser under the Contracts to the same extent as if the foregoing assignment and assumption had not occurred.

Section 2. Assignee Acknowledgement. Assignee acknowledges that it is fully and completely aware of all the terms and conditions set forth in the General Terms and Conditions, including without limitation and in particular with all provisions relating to the supply, delivery and licensing of Software to the Purchaser (the "Software Provisions"). Assignee agrees (i) to be bound by and subject to all terms and conditions set forth In the General Terms and Conditions relating to the Software Contract and/or the obligations and covenants assumed by Assignee pursuant to Section 1 above, and (ii) that in the event of any breach of any of the Software contract and/or the obligations and covenants assumed by Assignee pursuant to Section 1 above or any breach of any of the Software Provisions by Assignee or Assignor, Purchaser may proceed directly against, and may seek monetary damages and/or equitable relief from, Assignee to the extent provided under the provisions of the General Terms and conditions and the Software Contract."

2.15 As per this contract LTGL took over the responsibility for the supply of software whereas the hardware was being supplied by LTHPL. LTHPL was also providing the services in relation to the contract. The AR has explained that the telecom software acquired through the agreement with LTGL and the hardware acquired through LTIIPL has been used to setup wireless communication network in India. The brief note, provided by the appellant reads as under:

"Telecom Software,

The Telecom equipment (FWS- Flexent Wireless Solution or the Switch BTS- Base Transceiver Station. etc) require certain Software to execute the basic functions The Software are

- *System Software ,*
- *Office Dependent Software*

System Software is required to make the telecom Hardware to function properly. These Software are embedded with Hardware. It cannot be copied or reused until and unless the Hardware is changed. The Hardware embedded with this Software will perform following functions:

- *Call processing & Call control*
- *CDR (Call Data Record) generation*
- *FCAPS (Fault management, Configuration management, Accounting, Performance, Security) support*
- *BSS (Business Support System) control etc.*

The Office Dependant Software helps, the equipment to control the functions as per the site requirements. This Software are designed or modified as per the Network requirement.

In Lucent supplied Telecom equipment, there are three basic Software (which comprise both System Software and Office Dependent Software) used.

1. **DCS (Digital Cellular Switch) Software** ... This Software aids the FWS Hardware to perform Call processing & Call control and Charging.
2. **FMM (Flexent Mobility Manager) Software** ... This Software aids the FMM Hardware to perform the Management function.
3. ***UTS Software****.... This Software aids the 8Th Hardware to perform the Radio Network control.*

Central Location

The DCS Software & FMM Software are part of FWS Software and are always required as part of the Hardware. This cannot be reused.

The BTS Software is applied as per the requirement.

FWS and BTS Software are ordered ever/time the Hardware is ordered. FWS and BTS Software can be used only with Lucent equipment."

2.16 The AR has submitted that the appellant had placed 7 purchase orders with LTHPL for the purchase of hardware and had placed 7 purchase orders with LTGL for the supply of software. The AR has explained that the software supplied through this purchase orders was meant for the use in the hardware supplied through the purchase orders *by LTHPL. The AR has filed the copy of purchase orders also to explain the software supplied is meant for the use of hardware only. The chart of purchase orders of hardware and software reads as under:*

	H/W			S/W		
Sr.No.	**PO**	**Date**	**Value $**	**PO**	**Date**	**Value $**
1	13012535	16-Nov.2002	70,203,104	13012536	16-Nov-2002	30,157,500
2	13012539	16-Nov-2002	67,163,336	13012540	16-Nov-2002	28,848,070
3	13012363	12-Nov-2002	26,364,714	13014732	25-Dec-2002	11,299,252
4	13012361	12-Nov-2002	73,156,266	13014730	25-Dec-2002	31,464,456
5	13012891	23-Nov-2002	5,388,950	13012918	23-Nov-2002	299,177
6	13013459	4-Dec-2002	2,433,224	13013460	4-Dec-2002	194,300
7	13014935	28-Dec-2002	19,586,150	13014936	28-Dec-2002	8,394,100
			264,295,744			**110,656,855**

2.17 The AR has explained that through the hardware purchase orders appellant has purchased hardware, namely, Flexent Wireless Solution, Base Transceiver Station, spares for Flexent Wireless Solution, upgrade for Flexerit Wireless Solution. Against the hardware, namely, Fléxent Wireless Solution, Base Transceiver Station, spare parts for these two, corresponding software inducing upgrades of software has been supplied through the corresponding purchase order of software. The AR has explained that Base Transceiver Station (BTS) is installed at remote station whereas Flexent Mobility Manager and Digital Cellular Switch software are installed at the central location. The AR has accordingly explained that, for making the hardware operational the corresponding software was purchase from LTGL and installed on various locations namely Central Location and BTS.

2.18 With these facts the taxability of payment received by LTGL is examined. Section 3.1 of the Wireless Network General Terms and Conditions Contract dated 31.07.2002 provides for the total scope of the work namely, providing hardware, software, equipment, communications circuits, networks, services to the appellant by LTHPL. Section 3.1.1 reads as under:

> *"3.1.1 Vendor desires to provide hardware, software, equipment, communications circuits, networks, services, maintenance, management and other Work to Reliance, the Reliance Affiliates and the Users, and Reliance desires this work be performed. Reliance is entitled to acquire products and services that Vendor or any Vendor Affiliate generally makes available to other customers or that are set forth In a Document or as mutually agreed upon in writing by the Parties, pursuant to terms and conditions no lets favorable to Reliance than the prices, service levels, terms and conditions set forth in any then-current Document. Commencing on the applicable Commencement Date, Vendor shall perform the Work described in the Documents. All Work provided by or for the Vendor shall comply with all relevant Applicable Laws, Applicable Permits, Specifications, and best practices. Vendor shall also ensure that all Products and Services will,*

as a minimum, meet the performance and design requirements, functionality and capability defined in the appropriate Standard as set forth in the Specifications. In fulfilling the obligations hereunder, Vendor and Its subcontractors and suppliers shall abide by all Applicable Laws, rules, regulations, codes including tax laws, and regulations prevailing in India and all other applicable jurisdictions."

2.18 Under the Assignment Contract, rights, entitlements, covenants and obligations of LTHPL have passed to LTGL as per section-1 of the Assignment Contract (already quoted above in para 2.14) Section-15.1 of the Wireless Network General Terms and Conditions Contract reads as under:

"15.1 License Grants

15.1.1 Subject to the terms Of this Section 15, upon delivery of Software, Vendor hereby grants to Reliance or Its Affiliates (and to third parties whom Reliance or Its Affiliates have contracted to operate the Wireless Reliance Network on their behalf (and to the extent of the same) upon payment, or agreement to pay, the relevant license fees by Reliance and/ or its Affiliates, a perpetual, irrevocable, non-exclusive, unrestricted (within the Wireless Reliance Network), unlimited (where specifically so identified in the relevant Documents), royalty-free license, to use such Software for the benefit of Reliance In connection with the ownership, operation and maintenance of the Wireless Reliance Network in the Territory and the provision of relevant services in the Territory to Reliance's customers. The Software shall be used in accordance with the relevant Documents.

15.1.2 For the avoidance of doubt, the licenses referred to in Section 15.1.1 above are not intended to restrict the provision by Reliance of telecommunications services 'between the Wireless Reliance Network and customers outside the Territory via appropriate gateways either through appropriate interconnect agreements that Reliance may enter into with other operators or otherwise, provided, always that, unless otherwise agreed In writing, Reliance and its Affiliates shall not be permitted to deploy or use the Software acting as a carrier outside the Territory.

15.1.3 The aforementioned licenses set forth in Section 15.1.1 shall hereinafter be referred to as the "Software Licenses". Such Software Licenses shall not be transferred, assigned, sublicensed by, or used by outsources of, Reliance without Vendor's consent except with respect to (i) the sale of the Wireless Reliance Network (or any relevant component thereof); (ii) the financing of the Wireless Reliance Network (or any component thereof); or (iii) the outsourcing by Reliance of any operating or maintenance functions related to the Wireless Reliance Network; (or any component thereof); or (iii) the outsourcing by Reliance of. any operating or maintenance functions related to the Wireless Net work; or (iv) the transfer, assignment or sublicense by Reliance of the Software Licenses to the Reliance

Affiliate) (or vice versa) or between Reliance Affiliates, in conjunction with a transfer of a portion of the Wireless Reliance Network, provided that in each such case, such transferee, assignee, sublicensee or outsourcee agrees in writing to abide by all the terms and conditions set forth in this Section 15 and the Vendor is informed of the same in writing by Reliance and provided further that the rights, transferred, assigned, sublicensed or granted to outsourcees, as the case may be, shall be those reasonably necessary to fulfill the commercial purposes of such transaction. The assignee or sublicensee shall not be a direct competitor of the Vendor involved in the manufacture of telecommunications equipment.

15.1.4 Except as otherwise expressly set forth in the Documents, Reliance shall use such Software only for the operation of the Wireless Reliance Network, or, In the case where the Software is purchased by or on behalf of Reliance Affiliates, for the operations of such Reliance Affiliates in the Wireless Reliance Network. The Software Licenses grant Reliance or Reliance Affiliates no right to and Reliance or Reliance Affiliates will not, sublicense such Software or modify, decompile, reverse engineer, or disassemble, or in any other manner decode Software furnished as object code for any reason. Reliance and Reliance Affiliates shall not copy the Software, including firmware except for the purposes of making a limited number of archival copies (for backup use in operating and maintaining the Wireless Reliance Network) in accordance with the Documentation and/ or the relevant Agreement; or as otherwise authorized in writing by the, Vendor or as otherwise set, out in the relevant Documentation. Except as provided below, no license is granted to Reliance to use the Software outside of the Territory. For the avoidance of doubt, the changing by Reliance or Reliance Affiliates of tables and values in the Software, modification by Reliance and/or its Affiliates of the Software by using the tools provided in or with the Software or any modification, in accordance with and pursuant to the relevant Documentation, shall not constitute 'modification' of the Software provided always that Reliance may only change, amend or modify Software which is designed for 'customer access' and to be so modified.

15.1.5 Reliance agrees that the Software, whether or not modified, and all copies thereof made by Reliance, are owned by, and are copyrights of. Vendor, its Subcontractors or its suppliers, as appropriate, and Reliance shall:

(a) ensure that all copies of the Software shall, upon any reproduction by Reliance authorized by Vendor (where such authorization is required under the Documents) and whether or not in the same form or format as such Software, contain the same proprietary, confidentiality and copyright notices or legends (if any) which appear an the Software provided pursuant hereto; and

(b) hold secret and not disclose the Software to any person, except

to: (i) such of its employees, contractors, agents representatives or Reliance Affiliates that are involved in the operation, maintenance or management of the Wireless Reliance Network, and need to have access thereto to fulfill their duties in such capacity, or (ii) other Persons who need to use such Software to permit Integration of Equipment with other products and software of other suppliers and customers; pro vided that such persons agree, or are otherwise obligated, to hold secret and not disclose the Software to the same extent as if they were subject to the Documents, and provided further that if any such Person is a competitor of Vendor, involved in the manufacture of communications equipment Vendor must approve (such approval not to be unreasonably, withheld or delayed,) such use on a case-by-case basis on commercially reasonable terms and such use shall be subject to an appropriate non-disclosure agreement and

(c) when and if Reliance determines that it no longer needs the Software or if Reliance's Software Licenses are cancelled or finally terminated in accordance with and pursuant to the terms of this Section 15 of these General Terms, return all copes (except for any required back-up or archival copies) of such software to vendor or follow commercially reasonable written disposition instructions provided by the Vendor. If the Vendor authorizes disposition by erasure or destruction, Reliance shall remove from the medium on which Software resides all electronic evidence of the Software, both in Its original form and in all copies and derivations thereof, in such manner that prevents subsequent recovery of such original or derived Software.

15.1.6 If as contemplated in Section 15.1.3. Reliance or its Affiliate(s):

(i) elects to transfer, assign or sublicense any Software in conjunction with any portion of the Wireless Reliance Network to a third party, and where such Software shall remain in place or be moved within the Territory and used for substantially the same purpose as used by Reliance and where such third party resides' in the Territory and Is approved by the Vendor (which approval shall not be' unreasonably withheld or delayed); or

(ii) elects to transfer, assign or sublicense Software to a Reliance Affiliate, in conjunction, with any portion of the Wireless Reliance Network.

Then Reliance may so transfer, assign or sublicense its Software Licenses for the Software furnished under the Documents for use with such portion of the Wireless, Reliance Network, without the payment of any additional fees or monies of the Vendor. If, however, the Software Licenses for the Software contains usage or per subscriber limits and/or the processor to be used by transferee, assignee or sublicensee, as applicable, requires additional memory or hard disk space to meet the transferee's, assignee's or sublicensee's new or different requirements, then, unless otherwise agreed in writing, *Reliance shall only transfer its existing rights to the transferee and the transferee may be required to enter into an appropriate agreement with the Vendor to cover requirements over and above the rights which Reliance has already purchased and has transferred. The following conditions shall apply to transfers, assignments or sublicenses and relocations pursuant to this Section 15.1.6:*

(a) the right to use of such Software may be transferred, assigned or sublicensed, only together with the right to use in the environment under which It is generally utilized.

(b) before any such Software. is transferred, assigned or sublicensed, Reliance shall notify Vendor of such transfer, assignment or sublicense and the transferee, assignee or sublicensee, as applicable, shall have agreed in writing (a copy of which shall be provided to Vendor) to' keep the Software in confidence and to corresponding conditions respecting possession and use of Software as those imposed on Reliance under this Section 15; and

(c) the transferee, assignee or sublicensee, as applicable, shall have the same right and obligations to Software warranty and Software maintenance for such Software as the transferor, provided the transferee continues to pay the fees, Including recurring fees, if any, associated with such Software warranty or maintenance pursuant to the relevant Documents.

15.1.7 Except as otherwise provided in this Section 15 or in any of the Documents. Reliance, or any successor to Reliance's title in the relevant portion of the Wireless Reliance Network, shall have no right to transfer, assign or sublicense, Software furnished by Vendor under the Documents without the consent of Vendor, which consent shall not be unreasonably withheld or delayed. If Reliance or such successor elects to transfer or assign any portion of the Wireless Reliance Network purchased under the Documents for which it does not, under the Documents, have the right to transfer, assign or sublicense related Software, Vendor agrees that, upon written request of the transferee or assignee as applicable, of such portion of the Wireless Reliance Network, or of Reliance or such successor, Vendor shall not unreasonably refuse or fall to grant to the transferee, assignee or sublicensee, as applicable, as license to use such Software within the Territory upon payment by the transferee of a re-licensing fee to Vendor on commercially reasonable terms.

15.1.8 The rights and obligations of Reliance under the Software Licenses, shall survive the termination of all or any portion of the Documents, regardless of the cause of term/ nation, provided Reliance has met its material obligations as set forth in this Section 15. In the event that Reliance falls to pay applicable and undisputed Charges, Vendor may terminate Reliance's right to use the, Software to which such Charges apply; provided that Vendor has given written notice and details of such breach to Reliance and has advised Reliance of its intention to terminate, and Reliance has failed to make such payment *within thirty (30) days from Vendor's notice thereof. Such terminated rights shall be immediately reinstated upon payment of all applicable license fees. In no event other than as set forth in this Section 15.1.8 may Vendor terminate the Software Licenses or, Reliance's right to use, the Software Notwithstanding any other provision of the Documents, if there is a dispute hereunder, pending final resolution of such dispute, all of Re/lance's rights under the Documents shall continue in full force and effect, and Vendor will not terminate the Software Licenses, and so long as Reliance continues to pay Vendor applicable fees, Vendor will not terminate, suspend, interrupt or delay maintenance and support of the Software.*

*2.19 Perusal of sectlon-15.1 of the agreement reveals that the appellant has not received any right for transferring the software license or decompiling, reverse engineering, or disassembling it. The appellant has also got no power to decode the machine code of software**.** The appellant has got no power to make copies of software except for backup purposes. From the section-15.1 of the agreement, it is very apparent that the appellant has got the right to use software for Its business or personal purposes and has obtained no other rights.*

2.20 ***The issue whether software Is goods or intellectual property has*** *been determined by Hon'ble Supreme Court in the case of Tata Consultancy Services Vs. State of Andhra Pradesh (2004) 271 ITR 401. It was argued on behalf of Andhra Pradesh Government that the computer software is a intellectual property and providing it to anybody for consideration results in royalty income being generated to the software developer. Hon'ble Supreme Court examined the issue in detail and it was held that software is an intellectual property so long as it remains with the software developer. As soon as a copy of the software is produced and is placed on a media, it becomes goods. Software on media is not different from any book or canvas (in case of painting) or compact discs or cassettes in respect of songs and pictures. Hon'ble Supreme Court held that the software and the media cannot be split up since the media has a little value. Hon'ble Supreme Court has observed as under:*

"A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies' are made and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (In case of painting) or computer discs or cassettes, and marketed would become "goods". We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film as a video cassette/CD. In all such cases, the Intellectual property has been incorporated on a media for purposes of transfer. Sale is not *just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of*

paintings or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction of sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act."

2.21 It is therefore now established law that computer software after being put on to a media and sold has become goods like any other audio cassette or painting on canvas or a book. ***The AO was therefore not justified in holding that the computer software on a media continues to be intellectual property right. The issue of payment for acquisition of copy of software programme has been considers by Hon'ble ITAT Bangalore Bench in the case of Lucent Technologies Hindustan Ltd. Vs. ITO (2005) 92 ITD 366.*** *In this case the taxpayer had purchased from US company an integrated equipment which consisted of both hardware and software as one cannot function without help of other. The acquisition of software was inextricably linked to the acquisition of hardware and one could not function without the other. The assessee company which was engaged in the business of manufacturing and sale of electronic switching systems required for the telecommunication industry, did not deduct tax at source while making payment on the ground that acquisition of software was inextricably linked to the acquisition of hardware and as the transfer of software had taken place outside India, no profit accrued or arose or could be deemed to have accrued or arisen in India. The AO directed for deduction of tax at source u/s.195. Hon'ble ITAT, after appreciating the provisions of Article-12 of the Indo-US DTAA and the provisions of section 9(1)(vi) of the I.T. Act, has held that the assessee did not acquire any right in the software. The assessee had only acquired integrated equipment both of hardware and software from Lucent, USA. The assessee did not acquire any right to duplicate the software in making use of same. The software supplied by Lucent, USA is customer-specific and cannot be reused or duplicated in any other exchange where identical orders were placed by the DOT. It was held that the payment made for the purchase of software did not partake the character of royalty and as such there was no obligation to deduct tax at source. The facts in the case of appellant are quite similar to this decision. The hardware is being purchased and simultaneously software is also being purchased from LTGL. The software is for the uses in the hardware purchased simultaneously. As per the Contract conditions mentioned in section-15 of the agreement appellant did not acquire any right of duplication of software except for use in its own system.*

2.22 ***Section 9 of the I.T. Act provides for income deemed to accrue or arise in India.*** *Section 9(1)(vi) refers to accrual of income by way of royalty. Explanation-2 to section 9(1)(vi) provides the definition of royalty which reads as under:*

9. *Income deemed to accrue or arise in India.*

(1) The following incomes shall be deemed to accrue or arise in India:

(vi) in come by way of royalty payable by-

(a) *the Government; or*

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

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

Explanation 2. -For the purposes of this clause, "royalty" means consideration (inducing 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 license) 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 license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or

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

2.23 Clause (v) of Explanation-2 provides that the consideration received on transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work would be deemed to be royalty. Clause (i) of Explanation-2 similarly provides that consideration received on the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, secret formula or process or similar property would amount to royalty. Clause (iii) of Explanation-2 provides that consideration for the use of any patent, invention, model, design, secret formula or process *would amount to royalty.*

2.24 On the other hand, the definition of royalty in Article-12(3) of the Indo-Us DTAA provides as under:

*"**Article-12(3). The term "royalties" as used in this article means**:*

(a) payments of any kind received as consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, 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, Including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof; 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 payments derived by an enterprise described in paragraph 1 of article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of article 8."

2.25 It can clearly be seen that the definition of royalty in Article-l2(3) of the DTAA is more restrictive than what is provided in Section 9(1)(vi).

*2.26 **LTGL is a tax resident of USA and therefore is entitled to the benefit of DTAA over the provisions of the Income-tax Act. Consequently if the payment of software is not covered by the definition of royalty in Article-12 being covered by section 9(1)(vii) would be irrelevant**. Definition of royalty in Artfcle-l2(3) is in following parts:*

a) Consideration for the Use of, or the right to use, any copyright of a literary, artistic or scientific work.

b) Consideration for the use of or right to use of any Patent, trademark, design or model, plan, secret formula or process.

c) Consideration for the use of or right to Use cinematograph film or work on film, tape or other means of reproduction of the use in connection with radio or television broadcasting.

d) Consideration for the information concerning Industrial, commercial or scientific experience.

e) Including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof

The computer software can only be covered in item (a) or (b) above.

*2.27 **<u>Computer software as copyright.</u>***

Article-12(3)(a) provides that the consideration for the use of any copyright or right to use of any copyright is royalty.

Definition of copyright is not provided in the DTAA and therefore definition of copyright provided in the Copyright Act, 1957 is relevant. Section-13 of the Copyright Act provides as under:

***"13. Works in which copyright subsists**. (1) Subject to the provisions of this section and the other provisions of this Act, copyright shall subsist throughout India in the following classes of works, that is to say,-*

(a) original literary, dramatic, musical and artistic works;
(b) cinematograph films; and
(c) sound recording.

(2) Copyright shall not subsist in any work specified in sub-section(1), other than a work to which the provisions of section 40 or section 41 apply, unless,

(i) in the case of a published work, the work is first published in India, or where the work is first published outside India, the author is at the date of such publication, or in a case where the author was dead at that date, was at the time of his death, a citizen of India;

(ii) in the case of an unpublished work other than a work of architecture, the author is at the date of the making of the work a citizen of India or domiciled in India; and

(iii) in the case of a work of architecture, the work is located In India.

Explanation. In the case of a work of joint authorship, the conditions conferring copyright specified in this sub-section shall be satisfied by all the authors of the work

(3) Copyright shall not subsist-

(a) in any cinematograph film if a substantial part of the film is an infringement -of the copyright in any other work;

(b) in any sound recording made in respect of a literary, drama tic or musical work, if in making the sound recording, copyright in such work ahs been infringed.

(4) The copyright in a cinematograph film or a *sound recording shall not affect the separate copyright in any work in respect of which or a substantial part of which, the film, or, as the case may be, the sound recording is made.*

(5) In the case of a work of architecture copyright shall subsist only in the artistic character and design and shall not extend to processes or methods of construction"

2.28 Section-13 therefore clearly provides that - the copyright shall subsist only in respect of original literary, dramatic, musical and artistic works, cinematograph films and Sound recording. It is therefore clear that the copyright is different from the work. Copyright about work is not synonymous with that work. Copy right is an incorporeal property in a work (a corporeal property).

2.29 ***Section-14 of the Copyright Act provides*** *the definition of copyright which reads as under:*

"14. Meaning of Copyright*. For the purpose of this Act, "copyright" means the exclusive right subject to the provisions of this Act to do or authorise 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 inducing the storing of it in any medium by electronic means;

(ii) to issue copies of the work to the public and 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 any 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."

2.30 The definition of copyright in section-14 is exhaustive definition since the words used are 'copyright means'. Copyright is a bundle of rights mentioned in section-14 above. This right consists of right to reproduce the work, issues of copies of the work in public, performance of the work in public, making translation, adaptation, etc. In respect of computer programme relevant for the issue under consideration, copyright mainly consists of following rights:

(a) to produce the work in any material form.

(b) to issue copies of the work to the public.

(c) to sell or give on commercial rental or offer for sale or for commercial rental any copy of computer programme.

2.31 ***Examination of the agreement of the appellant with LTGL reveals that section-15 of the agreement quoted earlier forbids the appellant from transferring, assigning, sublicensing or using***

by outsourcing the software. The agreement also forbids the appellant from decompiling, reverse engineering, disassembling or decoding the software. Section-15 also contemplates that all copies of the software provided to the appellant are the copyright of LTGL. These copies shall be held secret and software shall not be disclosed to anybody else. Agreement provides that all copies of software shall be returned to LTGL upon termination or cancellation or the agreement. Agreement also provides that the appellant shall use the software only for the operation of wireless Reliance network and shall not sublicense or modify the software. The perusal of section-15 of the agreement clearly reveals that the appellant has got a copy of software for being used in its telecom network. The appellant has got no right as envisaged in section-14 of the Copyright Act to duplicate the software, to Issue copies of software in public or to give copies of software in rent or even to reverse engineer, decompile or modify the software. *The sum total of the conditions mentioned in the section-is is that LTGL has given no part of Copyright as envisaged in section-14 of the copyright to the appellant. Thus, sale of software by LTGL to the appellant cannot be said to be the transfer of the copyright to LTGL either in part or in whole. Thus, consideration paid by the appellant to LTGL for acquiring copy of software is not for the use of copyright or transfer of right to use of copyright. As mentioned above, copyright is different from the work In respect of which copyright subsist. The appellant has only got a copy of software without any part of the copyright of the software. Thus, payment made by the appellant for acquiring copy of software does not amount to royalty within the definition of Article-12(3) of the DTAA.*

2.32 ***Similar issue that whether the supply of a copy of software programme without transfer of any part of copyright amounts to royalty or not has been considered by various benches of ITAT recently. Hon'ble ITAT, Bangalore Bench in the case of Samsung Electronics Co. Ltd. Vs. ITO 93 TTJ 658, 276 ITR (AT) 1 has had a occasion to consider the similar case.*** *It was held in the case that the definition of royalty u/s.9(1)(vi) is wider than the definition of royalty in various DTAA. Since the provisions in the DTAA have to be followed, if they are more beneficial to the taxpayer then the definition of royalty in DTAA has to be considered. Hon'ble ITAT had observed that as per the agreement between the parties is case the taxpayer had acquired only a copy of the software or the copyright article whereas the copyright remained with the owner i.e. foreign party. It was held that upon the sale of copyright article incorporeal right to software i.e. copyright was not transferred to the assessee. It was held that right to use of a copyright is totally different from right to use the programme embedded in a cassette or CD or it may be a software. It was held that the sale of copy of copyright article called software did not amount to royalty within the definition of Article-12(3) of the Indo-US DTAA. Reliance was placed on the decision of Hon'ble Supreme Court in the case of Tata Consultancy Services 271 ITR 401.*

2.33 ***Hon'ble Special Bench ITAT Delhi had again an occasion to consider the similar issue in the case of Motorola Inc. (2005) 270 ITR (AT) 62, TTJ 01.*** *In this case the Hon'ble ITAT had discussed the provisions of the Copyright Act. They examined the conditions in the non-exclusive restricted license of the software and found-that the supplier of software had only transferred a copy of the software or copyrighted article but had not transferred any of the copyright. Under these circumstances, consideration received for the sale of Copyright article, namely, software was held not to be royalty, it was also held that copyright is different from the copyright article. In this case the issue of software provided to the cellular operator for setting up the cellular telephone network was covered. It was held that the software which is provided by the supplier for the use in the cellular network does not involve transfer of any part of copyright of the software but only amounts to sale of a copyrighted article, namely, the copy of computer programme. Copyright continue to remain with the supplier of the computer programme.*

2.34 The Hon'ble Delhi Bench of ITAT in the case of Lotus Asia Specific ITA No.564 to 566/Del/05 order dated 28.04.2006 have also examined the same issue and have held that in the cask of a sale of shrink-wrap software being a copyright~ article, consideration received does not amount to royalty as there -is no transfer of any part of copyright in the, computed programme which continues to remain with the software supplier.

2.35 The Hon'ble ITAT Bangalore Bench in the case of Sonata Information Technologies Ltd. ITA No.1561 to 1580/Bang/2004 dated 31.01.2006 have considered the issue of payment received on sale of computer software without transfer of any copyright. Hon'ble ITAT had examined the issue of royalty within the meaning of section 9(1)(vi) and as provided in the DTAA. Hon'ble ITAT had examined in detail the issue of royalty in respect of sale of shrink-wrap software. They also examined the copyright in respect of computer programme being the right to sell or given a commercial rental any copy of software programmes. The ITAT examined the genesis of additional copyright given in respect of computer programme in section 14(b)(ii) of the Copyright Act. The Hon'ble ITAT referred to <u>Berne convention, Rome convention, WIPO copyright treaty, TRIPS.</u> It was held that the copyright in the software is different from any right in the physical manifestation of the software contained in a CD floppy or on a hard Disc in which the software is downloaded. It was held that when a distributor of Microsoft acquires the copies of software, he does not acquires the distributor right which is a copyright within the meaning of section-14(a)(ii) or the right to sell or to give on commercial rental, a right under section 14(b)(ii). The distributor merely obtained the right to distribute the copyrighted material which is a property different from the property in the copyright in the software. The property contained in copyrighted material and the property contained in the copyright to software are two different rights and when a person acts as a distributor *for the copyrighted material he has not acquired the distribution rights within the meaning of section-14(a)(ii) r.w.s. 14(b)(ii).*

2.36 Hon'ble ITAT also made a reference to the OECD- Model Commentary in para-12 to 17 dealing with the payment of software. Reference to the UN Commentary 2001 on the UN Model Convention relating to Article 12 was also made. Hon'ble ITAT held that the Model Commentaries give the authoritative interpretation of the provisions of the DTAA and these are legal aid in interpretation of provisions of DTAA entered into by two sovereign countries. Hon'ble ITAT accordingly held that the payment received for the sale of copyrighted article, namely, a copy of computer programme without transfer of any of the copyright does not amount to royalty as per the DTAA.

2.37 The Hon'ble ITAT, Bangalore Bench in the case of Hewlett Packard India (P) Ltd. (2006) 5 SOT 660 (Bang) has also considered a similar case. In this case Indian company was engaged in the business of providing network solution to its customers. This activity includes sale of software packages to customers. For this purpose the Indian company had imported readymade software Packages from Hewlett Packard USA. The Indian company sold these software Packages to its customers in the packed conditions Hon'ble ITAT held that the consideration received by the foreign company for the sale of software Packages to the Indian company did not amount to royalty within the meaning of Artlcle-12(3) of the Indo-US DTAA. It was held that the sale of copyrighted article is different from the transfer of the copyright in the computer software.

2.38 It is therefore very apparent from several decisions of Hon'ble ITAT that in the case of sale of copyrighted article, namely, a copy of computer programme, payment received is not royalty if there is no transfer of copyright partly or wholly. Facts obtaining in the case of appellant clearly point that no part of the copyright as envisaged by section-14 of the Copyright Act has been transferred to the appellant by LTGL. Therefore the payment for purchase of software cannot amount to royalty within the meaning of Article-12(3)

2.39 The AO has also held the software can be treated as patent and invention and has failed to provide how it can be treated as patent and invention. Under the Copyright Act, computer programme has been treated as literary, artistic work worthy of copyright. Patent has been defined in the Patents Act, 1970 in Section-2(1)(m) meaning a patent for any invention granted under this Act. Invention has been defined in section-2(1)(j) of the Patents Act meaning a new product or process involving an inventive step and capable of industrial application. Section-3 of the Patents Act Provides "what are not Inventions", which reads as under:

"3. What are not inventions – The following are not inventions within the meaning of this Act, -

k) a mathematical or business method or a computer programe per se or algorithms;"

2.40 It is therefore very apparent that computer software cannot be patented. Thus computer software cannot be treated as patent as it is not covered by the Patents Act. Further invention has been defined in the Patents Act to mean a new product or process involving an inventive step and capable of industrial application. It is therefore apparent that the invention under the Patents Act means ether the product or a new process of the product. It does not include a computer software, Therefore, the software cannot be treated as a patent or invention. Arguments of the AO are therefore not accepted.

2.41 The AO has also referred to a Circular dated 29.12.2000 of the Govt. of Singapore exempting shrink-wrap software from withholding tax. The AO has held that because Singapore has granted specific exemption regarding payment for the acquisition of shrink-wrap software. Under the Income-tax Act, no such exemption has been provided and therefore payment received for supply of software is royalty. This issue was also be considered by ITAT Bangalore in the case of Sonata Information Technologies Ltd. (cited supra) wherein it has been held that one has to look at the position of law under the Income-tax Act, 1961 and not be guided by provisions of foreign statute unless it is shown what the statute deals with, its provisions and context of observation. No assistance can be drawn from a circular of Govt. of Singapore. Thus in the absence of the study of the Singapore Income-tax Law and Singapore Copyright Law, no Reliance can be placed on the Circular of Govt. of Singapore.

2.42 Hon'ble ITAT in the case of Sonata Information Technologies Ltd. has also considered the observations of USA in respect of acquisition of a copyrighted article as well as the observations of Australia regarding the acquisition of software. Hon'ble ITAT had held that under both US and Australia views, payments for acquisition of software being a copyrighted article do not amount to royalty but are payments only in respect of a copyrighted article. The appellant has produced the copy of Australian Taxation Office ruling TR93/12 from which it is seen that the payment received for a sale of copy of programme is only price of the sale of goods and does not amount to royalty. US observation on the copyrighted article as mentioned by the AO has also been perused by me. There is apparently no contradiction between the findings of the several benches of the ITAT and the US & Australia Tax Rulings.

2.43 The AO has also relied upon the decision of Hon'ble AAR in the ruling In P.No.30 of 1999, 238 1TR 296. I have examined this ruling. In this case no software was supplied. On the contrary a central processing facility was created which was being used by other party and for such uses payment was being made. It was held that the payment made for such uses amounted to royalty since process being used included secret formula, design, model and also proprietary software. The facts in the case of appellant are entirely different. The appellant has purchased copy of software programme. Ratio of ruling of ARR is therefore not applicable.

2.44 The AR has referred to the decision of Hon'ble Calcutta High Court in the case of Leonhardt Andhra Und Partner, Gmbri vs. Commissioner of Income-tax (2001) 249 ITR 418. The AR has explained that this decision is not applicable since at the relevant time there was no DTAA between India and Germany and the definition of 'royalties' given in sec.9(1)(vi), Explanation (2) was applied.

I have perused the order of the Hon'ble Calcutta High Court. In this case, the decision was rendered on the basis of definition of 'royalty' under the provision to explanation (2) to sect. 9(1)(vi) in the absence of DTAA between India and Germany. The definition of 'royalty' under explanation (2) is much wider then the definition given in Article 12 of the DTAA, e.g. the payment received for giving license in respect of copy right or a patent design, secret formal amounts to 'royalty' under item (i) Explanation (2) to sec. 9(1)(vi)., whereas the definition of royalty under Article 12(3) under the DTAA only talks about consideration received for the use of, or the right to use, any copyright, any patent, trademark, design or model, plant, secret formula or process etc. Thus definition of royalty is restrictive in DTAA and the provisions of the DTAA having overriding effect over the provision of the Income-tax Act, the definition of 'royalty' in the DTAA only would apply. In view of this the decision in the case of Leonhardt Andhra Und Partner, GmbH vs. CIT (cited supra) is not applicable. The AO has wrongly relied upon this decision.

2.45 With above discussion, it is held that the appellant under the Software Contract acquired only a copy of software programme and did not acquire any copyright over such software as envisaged by section-14 of the Copyright Act. Under these circumstances, payment made by the appellant to LTGL cannot be said to be payment for the use of or right to use of copyright. Thus, payment amounted only for purchase of copyrighted article and does not amount to royalty within the meaning of Artilce-12(3) of the DTAA. It is accordingly held that the AO was not justified in directing to deduct the tax at source u/s.195. No income accrues to LTGL in India against the payment of US 1106,56,855/- for the supply of software for use in the Reliance Telecom Network. Appeal on ground No. 1 to 7 is allowed.

11. Thus the learned CIT(A) accepted Reliance contentions that what it obtained was only a copyrighted article which does not have any copyrity and section 14 of Copyright Act does not apply as Reliance does not have any right to duplicate software, to issue copies of software. Ld CIT(A) relied on the Coordinate Bench decision in the case of Samsung Electronics 276 ITR (AT) 1, Lucent Technologies Hindustan Ltd. 92 ITD 366, Motorola Special Bench Decision reported in 270 ITR (AT) 62 and other Bangalore Bench decisions on the issue. Revenue is aggrieved.

12. Learned Special Counsel's arguments centred around the fact that what the assessee has obtained is only a license, which involved a copyright under the Copyright Act and the definition of Royalty under the Income Tax Act is also applicable. The detailed submissions canbe summarised as under: -

a) Rights in software are in the nature of copyright,

b) Licensing of software amounts to Royalty under the income tax even before amendment of 2012.

c) Even under Article 12 of DTAA use of copyright of a literary article, scientific work, secret formula, process and also for use of industrial, commercial or scientific equipment is Royalty read with Copyright Act of India.

Learned counsel, relying on the decision of the Hon'ble Delhi High Court in the case of Autodisk Inc. and Microsoft Computer (placed in the paper book at page 1698 to 1704) submitted that there is copyright involved as the infringement is punishable. He elaborated on OECD commentary, stand of India on OECD commentary. He mainly relied on the decision of the Hon'ble Karnataka High Court order in the case of CIT vs. Synopsis International Old Ltd. 212 Taxman 454 (Kar) and Samsung Electronics Ltd. 345 ITR 494 (Kar), CIT vs. Lucent Technologies 348 ITR 196 (Kar) and AAR decision in the case of Citrix Systems Asia Pacific PVt. Ltd. 343 ITR 1 (AAR). He also relied on the Coordinate Bench decision in the case of Microsoft/Gracemac Corporation 42 SOT 550 (Del) and other decisions for support. The learned counsel also submitted that Lucent has PE in India, so the profits are taxable in India.

13. The learned counsel of Reliance, Shri J.D. Mistry, referring to the main contracts relevant for the issue i.e., software contract, GTC and Assignment contracts submitted the main purpose of entering various contracts are for setting up mobile network and placed order for hardware and software and software does not work without the hardware network. The software is nothing but computer technology. As a sequeter by

computer programming, the equipment works which result in network communications. This software is specific to the machinery on which it works and is different from Shrink wrapped software which is sold off the self. Then referring to the 'copyright' argument, the learned counsel simplified the logic by referring to Income Tax commentary of Kanga & Palkiwala to submit the publisher may have copyrights of authors but the ultimate user by purchasing the book gets only a copyrighted article and no copyrights. It was the submission that Reliance has no interest in intellectual rights of seller and only interest Reliance has is as to how the network functions and helps in communication system. Since the software is in binary system, the word license is used but this is different from License of copyright contemplated in the Act. Reliance is not exploiting any license/copyright while using the software purchased.

14. Continuing the arguments, learned counsel referred to the master agreement where the contract is for supply of hardware, software and services for establishing the network. It was the submission that the software supply contract was assigned to M/s. Lucent LLC USA and the same was to ensure that the software helps in equipment usage, as the equipment can work only with the software. He referred to the purchase order placed, as is referred by the learned CIT(A) that each purchase of equipment matches with placing order for relevant software and the software is the medium/mechanism for using the hardware. Referring to clause 15 of the agreement, the arguments were that the license was given for use of non-tangible goods unlike hardware refer to various terms specified therein to submit that license is only for exclusive use by Reliance and no intellectual property right were transferred nor any copyrights were given.

15. The learned counsel referred to OECD commentary on Royalty, Software License agreements and provisions of the Act, DTAA and Copyright Act. He also distinguished the case law relied on by the learned counsel of Revenue. The learned counsel distinguished the decisions of Autodesk and Microsoft relied on by the Revenue submitting that they are given in the context of violation of copyright which are not involved in this transaction

and does not apply. With reference to the Revenue's contentions about the amended provisions of IT Act, it was submitted that the DTAA (Article 12) has not been amended and so it has no application. He referred to the decision of B4U Int.holdings ltd in ITA/3326/Mum/2006 dt. 28/05/12 (Para 13-17) in support. Likewise decisions of WNS North America Inc in ITA 8621/M/2010 dated 14.12.2012 (para 3.6 to 3.10). It was also submitted that the decisions of Karnataka High Court in the case of Synopsis International (page 1711 in Paper Book) is about designing mechanism and considered in the context of definition under section 9(1)(vi) of the IT Act whereas DTAA overrides the said provisions. Moreover, it was submitted that the issues involved is with reference to right 'in respect of 'copyright used in DTAA.

16. It was clarified that service agreement was assigned to Lucent Alcatel and referred to the findings of learned CIT(A) (para 2.14) to submit that the Reliance is purchasing as and when modules were added (add-on-modules). The learned counsel also distinguished the decision of the Hon'ble Karnataka High Court in the case of Samsung Electronics. It was submitted that the Reliance has not purchased Shrink Wrapped product, there is no right to copy. So no copyrights and provisions of Copyright Act was wrongly applied. Regarding the argument of Revenue that OECD commentary was not accepted/followed by India, the learned counsel for the Reliance referred to the decisions of: -

(1) Visakhapatnam Prot Trust 146 ITR 146 (AP)
(2) Graphite India 86 ITD 384
(3) James Mackintosh & Co P Ltd 93 ITD 466 (Pune)
(4) Metchem Canada Inc 5 SOT 121 (Mum)

It was the submission that OECD commentary was relied on even by the Special Bench in the case Motorola (supra) in order to interpret the DTAA. The learned counsel then relied on the following cases in support of the contentions:

1) DIT vs Ericson AB 204 Taxmann 192.
2) Solid Works corporation 51 SOT 34.

3) Allianz SE in ITA/1569/PN/08 dt. 14/03/12.
4) Sonata information Tech Ltd. in ITA4446/Mum/2011 dt.03/04/12.
5) Tata Consultancy Services Ltd 271 ITR 401(SC).
6) BSNL Vs Union of India 2006(2) S. T. R 161(SC)

17. The learned counsel also submitted detailed note on 'Royalties' under various treaties as the Reliance also purchased from various other Country-Resident companies. Arguments were also placed on 'goods', 'equipment' used in definitions. Lastly, it was also contended that the issue of existence of PE in the case of Lucent cannot be considered as AO has not raised the issue in his order. It was his submission that additional grounds cannot fasten liability.

18. In reply, the learned counsel for Revenue relied on the decision of NTPC to submit that Revenue can raise new ground/argument which is legal. It was his argument that the agreement was assigned to LTGL and not executed by Lucent india. He reiterated the contention that License is for use of copyright and not for copyrighted articles. He referred to the ownership and redesigning of software at the end of 10 year period to submit that software is not sold, only license to use was granted. Referring to the terms of agreement, it was submitted that when software was supplied through a medium of CD, Reliance has only license to use the same and in the case of software, it can only be treated as use of copyright. As an alternative submission, it was also contended that the use of software can also be considered as 'use of equipment' when it is loaded on CD becomes a tangible item and works through the computers. Since the software is to be referred as provided in clause 15.1.5, it is not taken as use of copyright, it can also be taken as use of equipment under DTAA. The learned counsel for Revenue submitted that in the case of product patent there can be sale but, a process patent can only licensed.

ITA Nos. 7001/M/10 to 7004/ M/10 – Lucent Technologies GRL LLC

19. The facts in this case are, Lucent is a company incorporated in and a tax resident of USA. It supplied software to Reliance lnfocomm Ltd. (Now known as Reliance Communications Ltd.) for its wireless Reliance network.

The assessment order u/s.143(3) dated 30.12.2008 was passed for A.Y. 2006-07 where total receipts of the Lucent amounting to Rs.162.77 crores was brought to tax as 'Royalty' even though the Lucent had claimed the same was non-taxable. It was noticed that an agreement under which software was supplied was operative w.e.f. 5.8.2002 and the Lucent was in receipt of similar payment for other years also. In view of this, after recording reasons, the A.O. initiated proceedings u/s*.147* for all years covered in the order. On going through the relevant clauses of the Agreement, AO held that what the Reliance is getting is the license to use the software, no other title or interest in the software is transferred to the payer, hence there is no question of sale of software per se. If, at all there is an element of sale, it is only in respect of the carrier media i.e. the floppy or CD in which the software is transacted. However, in view of the enormous difference in the values of the carrier media and the software, the 'sale' of carrier media is ignored being very small. AO did not agree that it was sale for the following reasons: -

1. License remains a license, irrespective of the period involved and
2. In this fast paced technological progress, the rate of obsolescence in software is very high.

Hence, license in perpetuity has no significance since the economic life of software itself is limited. The title and proprietary rights would remain with Lucent. AO gave a finding that it is quite clear from the section 15 of the Wireless Network General terms and conditions Contract that the software is the property of Lucent. It has also provided in the Agreement that the applicant would not be the owner Software but would remain the licensee for the use of or the right to the copy right. It is no way to reconstitute as a sale of software.

20. Lucent argued before AO that Reliance has been granted in perpetuity irrevocable, non-exclusive, unrestricted, unlimited royalty free license to use the software for its benefit in connection with the ownership, operation and maintenance of its Wireless Reliance Network. The intellectual property rights in the software vests with the Lucent and Reliance is not permitted to transfer, assign, sub-license such software or modify,

decompile, reverse engineer, or disassemble or in any other manner decode the software furnished, as object code. Reliance is also not permitted to make copies of the software except for back up purposes. The consideration received for supply of software is not in the nature of royalty since Reliance has not been granted any rights in the underlying copyrights of the software. Therefore, Reliance merely purchases a copy of the copyrighted article namely, a computer program, called 'software', which is a standard commercial software and can be supplied to any other telephony network player. The Lucent further argued that the payment is not covered by Copyright Act also and so cannot be considered in the nature of royalty.

21. AO discussed the issue about the receipts assessable as Royalty. His detailed order on the issue is as under:

"To appreciate the nature of the transaction it is necessary to appreciate the special nature of software, the nature of transfers of software, sale of software, the concepts of royalty, etc which are dealt with in detail below:

4.1. ***What is software?***

The phrase "computer software" is commonly used to describe computer programs and ancillary materials associated with the development and operation of a computer program, but which does not include computer hardware. Explanation 3 to section 9(1)(vi) specifically defines a software as under -

'Explanation 3.---For the purposes of this clause, "computer software" means any computer Program recorded on any disc, tape, perforated media or other information storage device and includes any such Program or any customized electronic data;

Clause (b) of explanation to Section 8OHHE also defines software as -

(b) "computer software" means,—

(i) any computer program recorded on any disc, tape, (~ I perforated media or other information storage device, or

(ii) any customised electronic data or any product or service of similar nature as may be notified by the Board, which is transmitted or exported from India to a place outside India by any means

A computer program is a series of instructions written in a language which computer can understand and execute. When a program is run, three processes are involved namely input, processing and output. A program is normally written in a computer language say cobol, c+, fortran, basic etc. This is known as "source code". When this program is *converted into an executable form so that computer can understand the same, it is called "object code". A user of program normally gets the object code and not the source code. The source code remains secret property of the developer.*

4.2. ***Transfers in respect of software.***

In the present case, we are concerned with granting of license to use a software developed by the assessee to Reliance Communications Ltd (earlier known as Reliance hnfocomm). Reliance has been granted a non-transferable right. The seller has indemnified the buyer/Licensee against any breach of any intellectual property or Patent regulations in using, maintaining or transferring of the software tools.

4.3. ***Whether sale of software is sale of Goods?***

4.3.1 The title and proprietary notices of the software would remain with assessee. who is the owner of the programme. The Software Distribution/ Reseller Agreement makes it very clear that the software is the property of the assessee. It is also provided in the Agreement that the user would not be the owner of the Software but would remain the licensee for the use of or the right to use of the copyright. It is in no way to constitute as a sale of software.

4.3.2 The assessee has relied upon the decision of Constitutional Bench of Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh (20041141 Taxman 132 (SC). In this case, Supreme Court was concerned with canned software (i.e. computer software packages off the shelf). It was concerned with sale of canned software and whether such canned software can be termed as 'goods' and as such can it be assessable to sales tax. Supreme Court held that sale o software is clearly a sale of 'goods' within the meaning of Sec.2(h) of Andhra Pradesh General Sales Tax Act, 1957 and Article 366 of the Constitution of India. It was also held that <u>no distinction can be made between branded and unbranded software</u>. Supreme Court made <u>certain interesting observations</u> which are summarized below :- -

"The <u>term 'goods' as used in Article 366(12) of the Constitution and as defined under the Act is very wide and includes all types of movable properties, whether those properties be tangible or intangible</u>. 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, they become 'goods', which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books'&~ canvas (in case of painting) or computer discs or cassettes, and marketed would become 'goods'.
(Para 17)

\- *The Copyright Act, 1957 and the Saleb Tax Act are also not statutes in pani materia and as such the <u>definition contained in the former should not be applied in the latter</u>.*

(Para 30)

\- *In the instant case, the Supreme Court was not concerned with the technical meaning of computer and computen programme as in a fiscal statute plain meaning rule is applied. (Para 50)*

- *In interpreting an expression used in a legal sense, the Courts are required to ascertain the precise connotation which it possesses in law. It is furthermore trite that a Court should not be overzealous in searching ambiguities or obscurities in words which are plain. (Para 51)*

\- *It is well-settled that when an expression is capable of more than one meanings, the Court would attempt to resolve that ambiguity in a manner consistent with the purpose of the provisions and with regard to the consequences of the alternative constructions". (Para 52)*

4.3.3 Let us now consider the applicability of Tata Consultancy Services Co.'s case (supra) for the transaction under consideration. It is pertinent to consider the contention usually raised that as 'Software' is - a tariff item both under the Customs and Excise Laws and Sales Tax Acts, the provisions of Sec.195 are not applicable, as Sec.195 is not applicable to payments made for import of goods. In this regard, it is to note that 'Package Softwanes' are neither goods nor services; they are a separate 'genre by itself. i.e. intellectual property. The mere fact that customs law or sales tax law deems it to be goods for the purpose of their Act, does not change the inherent character of the 'software'. In fact, World Trade Organisation (WTO) which has been ratified by more than 140 countries, has 3 main agreements:

1. *Agreement on trade of goods (GATT)*
2. *Agreement on trade of services (GATS)*
3. *Agreement on trade of intellectual property rights (TRIPS)*

This goes on to indicate that lPRs (Software is an IPR) are a distinct and different class than those of goods and I or services. In fact, the software may also be considered as a "process', but this aspect is discussed later.

4.3.4 Thus, as per the Income Tax Act it is clear that the payment made for the purchase of software by the user can be considered as payment for use of intellectual property and not for the purchase of goods. The only exception provided is by the second proviso to sec. 9(1) (vi), which excludes the computer software supplied by a non-resident manufacturers along with a computer or computer based equipment under any scheme approved under the policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.

4.3.5 The decision of the Tata Consultancy Services (supra) relied upon by the assessee is distinguishable with the facts of the present case. The Hon'ble Authority for Advance Rulings (Income Tax New Delhi) in the case of Airports Authority of India, in their judgement in A.A.R. Nos.755-756 of 2007 dated 28.07.2008 discussed the issue in length and it was of opinion that decision is not applicable in such type of cases. The relevant portion is reproduced hereinunder:

"We may now turn to the contention of the applicant that software is goods and that the present case involves sale of copyrighted article. As we have mentioned above, the applicant has derived support from Tata Consultancy Services Co's case (supra) for the first proposition and Article 12 of the OECD Model Tax Convention for the second proposition. Tate Consultant Services Co. ~s case (supra) is a decision rendered by a Constitution Bench of the Supreme Court in a sales tax matter The appellant therein provided consultancy services, including computer consultancy services. As per their business, they prepared and loaded on customer's computers custom made software (uncanned software) and also off the shelf sold standard software (canned software). The canned software were copyrighted products of Oracles, Lotus, Master Key. etc. The commercial tax officer of Andhra Pradesh assessed sales of canned software to sales tax. The question that arose for the consideration of the Supreme Court was whether the canned software sold by the appellant could be termed as 'goods' and assessed to tax under the Andhra Pradesh General Sales Tax Act, 1957. The Court held that the expression 'goods' as defined in Article 366(12) of the Constitution of India and as also defined under section 2(h) of the Andhra Pradesh General Sales Tax Act, 1957 was very wide and included all types of movable property — whether tangible or intangible goods' for the purpose of sales tax could not thus be given narrow meaning. The real test whether an article was 'goods' or not was whether it was capable of abstraction, consumption and use and whether it could be transmitted, transferred, delivered, stored or possessed. A software programme might consist of various commands which enable the computers to perform a designated task But the moment it was put on a disc and copies ware made and marketed. it became chattel exigible to sales tax. Intellectual property, once it was put on to media, whether in the form of books, canvas, computer disc or cassettes and marketed, would become goods. The Supreme Court referred to its earlier decision in Associated Cement Companies Ltd V Commission of Customs 2001 AIR (SC) 862 which it felt directly dealt with the question in issue. The question in Associated Cement Companies Ltd.'s case (supra) was whether customs duty was leviable on technical material supplied in the form of drawings, manuals and computer disc, etc. The Court observed that the Customs Act defined 'goods' to include all kinds of movable property It held that what was being taxed under the Customs Act read with Customs Tariff Act and the Customs Valuation Rules was not the intellectual input alone but goods whose value had been enhanced by the said input. The final product at the time of import was either the magazine or the encyclopaedia or the engineering drawings or disc, as the case may be, and the charge of duty was on the final product. There was no scope for splitting the engineering drawing or the encyclopaedia into intellectual input on the one hand and the paper on which it is scribed on the other.

It may be mentioned that the legislative scheme of sales tax law and income tax law are very different. While the object of sales tax law is to tax transactions of sale of movable properties, Income Tax law is concerned with taxing incomes and profits of individuals, companies and other entities in whatever manner' earned. For this purpose, income has been classified into different types, like business income, income from house property, salary income, capital gains, royalty income, etc., which have been given tax treatments. Under The sales tax law, the definitions of the terms 'goods' and 'sale' have been kept very wide. 'Goods' includes all kinds of movable properties, including intangible things like electricity. Delivery of goods on hire purchase and the transfer of right to use goods are deemed under this of law as amounting to sale. There is no provision with regard to royalty under the Sales Tax law. As could be seen from Tata Consultancy Services' case (supra). the Court has treated the disc / floppy containing the software as goods, whose value has been greatly enhanced because of the intellectual property as such has not been regarded as a taxable event. On the other hand, under the Income Tax Act as well as DTAA the payment made in lieu of transfer of right to use copyright is a royalty income. The transfer of disc / floppy on which the copyrighted software has been inscribed is immaterial for this purpose.

It is well settled that legal propositions are only authoritative in so far as they are relevant to the facts in issue in a case. The ratio decidendi of a court decision, which has binding authority, must thus be read in the light of the facts of the case and the issue considered. The Supreme Court has pointed out the following in CIT Vs. Sun Engineering Works (P) Ltd. (1992) 198 ITR 297 (SC):

"….. it is neither desirable nor permissible to pick out a word or a sentence from the judgement of this court, divorced from the context of question under consideration and treat it to be the complete 'law' declared by this court. The judgement must be mad as a whole and the observations from the judgement have to be considered in the light of the questions which were before this court. A decision of this court takes its colour from the questions involved in the case in which it is rendered and, while applying the decision to a later case, the courts must carefully try to ascertain the true principle laid down by the decision of this court and to pick out words or sentences from the judgement, divorced from the context of the questions under consideration by this court, to support their reasonings..."

As we have pointed out above, in Tata Consultancy Services' case (supra) the issue under consideration was whether sale of disc / floppy containing software programme amounted to sale of goods under the sales tax law of Andhra Pradesh. In fact, the issue of transfer of right to use the goods (as per expanded definition of sale) did not come up for consideration in that case. On the other hand, the issue under consideration in the present case is different. The question here is whether the consideration is paid for the use or right

> *to use copy right in which case it will be royalty income. As is clear from the contract provisions, there is no outright transfer of copyright or sale of disc/ floppy containing software programme in the present case. The factual background and the legislative provisions with reference to which Tata Consultancy Services' case (supra) was decided, are quite different from those of the present case. Thus the applicant can seek no support from the said decision in order to assail the correctness of the view taken by the Authority in the earlier case of the applicant"*

4.3.6 ***The software is also covered within the scope of explanation (2)(via) to sec. 9(1)(vi) which deals with the use or tight to use any industrial, commercial or scientific equipment****. Hon'ble ITAT, Hyderabad also held in case of M/s Frontline soft Limited ITA no 1080-1081/Hyderabad/03 held vide para 25 as below:*

> *25 The Apex Court in the case of Tata Consultancy Services v. State of A.P. 271 ITR 401 (SC) = (2004-TIOL-87-SC-CT-LB) held that notwithstanding the fact that computer software is intellectual property, whether it is conveyed in diskettes, magnetic tapes of C. D. Roms. whether canned or uncanned. whether it conies as part of the computer or independently, whether it is branded or unbranded, tangible or intangible, it is a commodity capable of being transmitted, transformed, delivered, stored, processed etc. therefore it is 'goods' liable to sales-tax. The above judgement is in respect of A.P. sales tax Act. By the expedient of "deemed fiction" or "inclusive definition" Parliament and state Legislatures are competent to give a specific statute only. Such definition cannot be imported in different statutes which define the same transactions differently. Royalty has specifically defined in Income-tax provisions, 9(1) (vi) Explanation 2 (iva). Therefore, same is only required to be considered for the purposes of income-tax. The decision in the case of Sonata Software Ltd. vs. ITO (6 SOT 700) (Ban galore) = (2006-TIOL-270-lTAT-BANG) is distinguishable on facts as in that case clause (iva) to Explanation 2 to section 9(1) (vi) inserted by the Finance Act 2001 w. e. f. 2002-03 has not been considered."*

4.3.7 In view of the above the Reliance on the case of Tata Consultancy Limited by the assessee is misplaced. It may also be mentioned here that various other decisions which have been relied upon by the assessee also considered and relied upon the decision in case of Tata Consultancy Limited, and so all these decisions will not help the assessee.

4.4. ***Concept of Royalty***

4.4.1 The term 'royalty' normally connotes the payment made to a person who has exclusive right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or a thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. Intellectual property law is that area of law, which is concerned with the protection *of ideas, the expression of ideas, invention and commercial goodwill. It includes copyright law, the law of patents, breach of confidence, design law, trademark law and the law of passing-off.*

4.4.2 The Karnataka High Court in the case of Citizen Watch Co. Ltd. [148 ITR 774 (Kar.) and the Calcutta High Court in the case of Davy Ashmore India Ltd. (190 ITR 626 (Cal) have also clearly held that the royalty is a payment for grant of right to use any property, the ownership of which continues to vest with the grantor. This means that only in cases where ownership of the asset in question is retained and the right to use is granted, the payment of the same will constitute royalty.

4.4.3 For the purposes of interpretation of the DTAA, one has to go by the general meaning of the term 'royalty' in view of the decision of the Special Bench of the Tribunal in the case of Siemens Aktiengesellschaft v. ITO (1987) 22 lTD 87 (Born.) and not by the definition as contained in Explanation 2 to section 9(1)(vi). The general meaning of royalty, after considering the Calcutta High Court decision in CIT v. Stanton & Stavely (Overseas) Ltd. t19841 146 ITR 405, its definition meaning given in Encyclopedia Britannica (1972 Edition) and Gujarat High Court decision in CIT v. Ahmedabad Mfg. & Calico Printing Co. (19831 139 ITR 806 and others, the Hon'ble ITAT observed as under:

> *"It is thus clear that the general concept of the term 'royalty' does not rule out 'lump sum payments' being considered as 'royalty' as well as payments made for know-how. The mere fact that a particular knowledge, which is imparted may not be statutorily protected as in the case of a patent or trade mark would not take it outside the purview of the term 'royalty'. It may be that the knowledge imparted is only contractually protected. It may even be that there is no protection for the knowledge so granted. Even so the observations which we have set out above clearly show that the form of legal protection has no conclusive impact in determining whether payment is 'royalty' or not, nor the nature and mode of payment whether lump sum, single, or periodic, nor the question that it does not cover know-how. The dictionary meanings of the term 'royalty' relied on by the learned counsel for the assessee and adverted to in paragraph 18 of our order are only indicative of circumstances to which payments can be considered to be royalty and are not exhaustive as to the content of the term."*

4.4.4 In general, the concept of royalty is a payment for use of a property, the ownership of which remains with the developer and only a limited right is given to the user. It is not necessary that the property should be protected by a statute.

4.5. ***Why separate clauses for Royalty and FTS***

4.5.1 The section 9(1)(vi) of the Act was introduced by the Finance Act, 1976 w.e.f 01.01.1977. The CBDT circular No. 202 explained the intention of the legislation in this regard as under -

> *"Source rule for "royalty"--Section 9(1)(vi)*

15.1 A non-resident taxpayer is chargeable to tax in India in respect of income by way of royalty, which is received or is deemed to be received in India or which accrues or arises or is deemed to accrue or arise in India. The Income-tax Act, however, does not contain any definition of the term "royalty" nor is there any clear-cut source rule specifying the circumstances in which royalty income can be regarded as accruing or arising in India. Further, lump sum payments made for the supply of know-how are not chargeable to tax where such know-how is supplied from abroad and the payment therefore is made outside India even though the know-how is used in India, if no part thereof is attributable to any services rendered in India.

15.2 The Finance Act has inserted a new clause (vi) in section 9(1) of the Income-tax Act clearly specifying the circumstances in which the royalty income will be deemed to accrue or arise in India and also defining the term "royalty"

15.4 In view of the aforesaid amendment, royalty income consisting of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawings or specifications relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, will ordinarily become chargeable to tax in India.

15.5 For the purposes of the aforesaid source rule, "royalty" has been defined in Explanation 2 to section 9(1)(vi). It will be seen that the definition is wide enough to cover both industrial royalties as well as copyright royalties. Further, the definition specifically excludes income which would be chargeable to tax under the head "Capital gains" and accordingly such income will be charged to tax as capital gains on a net basis under the relevant provisions of the law.

4.5.2 From the above it can be seen that the intention of the legislation is very clear and the same is to bring to tax all payments made for the acquisition of know how in any form, where the source of payment is in India. This is in accordance with the internationally recognized and accepted principle on distribution of tax revenue between source state and resident state. The OECD model and UN model convention on tax treaties have separate clause for taxation of royalty in the source state.

4.6. ***Definition of Royalty under domestic law***

4.6.1 The relevant section 9(1)(vi) of the Income Tax Act 1961 reads as under–

9(1). The following incomes shall be deemed to accrue or arise in India:

… … …

(vi) income by way of royalty payable by-

(a) the Government; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for

the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

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

4.6.2 It can be seen that section 9(1)(vi)(b) provides that if a resident makes a payment to a non-resident, the such sum payable shall be deemed to be income of the payee accruing or arising in India if the following two conditions are satisfied -

i. *The payment should be in the nature of royalty as defined under explanation 2 to the sub section.*
ii. *The purpose of the payment should be neither for the business carried out by such person outside India nor for making or earning an income from a source outside India.*

4.6.3 The assessee's basic argument is that the payment does not fall under the mischief of explanation 2 to section 9(1(vi) of the Act. The term Royalty' has been defined under Explanation 2 to Section 9(1)(vi) of the Act to mean:

"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 license) In respect of a patent Invention, model, design, secret formula or process or trade mark or similar pro petty;

(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 trademark, or similar property;

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

(iva) the use or right to use, any industrial, commercial or scientific equipment, but not including the amounts referred to in section 4488;

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

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

4.6.4 An analysis of the above definition of royalty would show the following categories fall under the scope of royalty -

(i) Patents, designs, invention, secret formula, process etc.

(ii) Information concerning technical, industrial or commercial or scientific knowledge etc.

(iii) Equipment - Industrial, commercial or scientific.

(iv) Literary, artistic or scientific work

4.6.5 In the case of first three categories, payment for mere use is the royalty whereas in the fourth category, the royalty arises only when copyright right is transferred. The next question would be, whether items like design, invention etc. are not the scientific work or in other words whether categories (i) to (iii) and (iv) are mutually exclusive or overlapping? There can not be any dispute on the fact that invention, design, secret formula or process are in the nature of scientific work. Thus, the four categories are not mutually exclusive. The only inference one can draw is that the first two categories represent intangible properties whereas the third and fourth category includes all kinds of properties. In the case of intangible property, even a mere use of it would attract the provisions of royalty whereas in the case of tangible properties, only when a copyright right is transferred, it would fall under the scope of royalty. Only exception in the case of tangible properties is the equipment. The use of equipment is also covered by the scope of royalty w.e.f. 01/04(2002.

4.6.6 The clauses (i) and (iii) refers to the same category of properties i.e patent, invention, model etc. In clause (i). payment of "transfer of any right" in respect of such properties but clause (iii) refers to actual 'use' of such properties. What is the distinction between a 'right to use' and 'use'. It can be understood by a simple example of taking a house on rent vis-a vis subletting to a third party- In this case, a tenant as well as subtenant pay rent. A tenant makes the payment for his right to use whereas the sub tenant pays for actual use of the house. Similar is the situation when a vendor in India acquires know-how from abroad and sells it to actual user. In this case the vendor acquires a right to use covered by clause (i) whereas the actual user pays for actual use covered by clause (iii) of the explanation.

4.6.7 Thus as per the provisions of Sec.9(1)(vi) of the income Tax Act 1961, any payment on account of Royalty made by the Resident of India to any person outside India is deemed to be income of the recipient in India, and would be deemed to be the income chargeable to income tax in India. One has now to examine whether such payments partake the character of "Royalty" as defined in the Sec.9(1)(vi) itself, As discussed above, clause (i) to (iv) are applicable In the case of intangible property and payment for its mere use is in the nature of royalty. As mentioned *above, software Is not goods but an intangible property. Hence consideration paid for its use or right to use is in the nature of royalty.*

4.7. ***Whether "process"? -***

4.7.1 Alternative to the above discussion, it is to be seen whether 'software' fits into one of the categories mentioned in clause (i) and (iii) of explanation 2 to Sec.9(1)(vi). Klaus Vogel in his commentary on the phrase 'secret formula or processes' has stated that definition cover know-how in a narrower sense of the term, viz, all business secrets of a commercial or industrial nature [Para 59/Article 12~. In most countries, they enjoy at least a relative protection or are capable of being protected.

4.7.2 In New Skies Satellites vs. ADIT (ITAT Delhi Special Bench) ITA no 5385-87/2004 (Decision dated 16/10(2009) it was held that the provision of the transponder through which the telecasting companies are able to uplink the desired images/data and downlink the same in the desired area is a "process". To constitute "royalty", it is not necessary that the process should be a "secret process". The fact there is a 'comma' after the words "secret formula or process" in the DTM does not mean that a different interpretation has to be given to the DIM as compared to the Act.

It was further held that the argument that there is no "use" of the satellite by the payer as it has no control or possession of the satellite is not acceptable. To constitute "royalty", it is not necessary that the instruments through which the "process" is carried on should be in the control or possession of the payer. The context and factual situation has to be kept in mind to determine that whether the process was "used" by the payer. In the case of satellites physical control and possession of the process can neither be with the satellite companies nor with the telecasting companies. The fact that the telecasting companies are enabled to telecast their programmes by uplinking and downlinking the same with the help of that process shows that they have "use" of the same. Time of telecast and the nature of programme, all depends upon the telecasting companies and, thus they are using that process;

4.7.3 The '<u>process</u>' has been defined in Ordinary Dictionary as "a particular course of action intended to achieve a result". It is a co-cordinated set of actions that produce a result. White Information Technology has automated specific tasks for pre-defined workflow, the advent of web services opens the prospect of automating the entire end-to-end processes without sacrificing business agility.

4.7.4 As per Corpus Juris Secundum, the meaning of the term "process" as understood n Patent Laws is:

> * *A mode, method or operation whereb~' a result or effect is produced.*
>
> * *a means devised for the production of a given result.*
>
> * *an operation done by rule in order to secure a result.*

This is exactly how a software works - in a series of instructions/ operations to achieve a desired result. The program which instructs a computer to perform the desired operation often goes through a series of evolutionary steps from preliminary conception to detailed and complex expression. In this process (which varies from case to case) -a crucial stage in the conception is often the expression of the basic steps to be executed-the algorithm-in the form of a flow-chart or other logical flow diagram. Thereafter the statement of instructions in a computer language is relatively unskilled though it may be very laborious. The detailed writing will likely be in a so-called 'high level' language (such as Fortran or Cobol). giving the diagram in source code. The computer itself then converts this into operational terms of object code, by means of a separate 'system control' program. 'Computer Program' is a term that may describe a wide range of phenomena, from basic algorithms capable of application in an indefinite number of more specific uses to detailed instructions for the solution of particular problems. A different complication is this: the result of actually using a Programmed computer is to produce information which may be taken for itself, or may immediately be put to some further use, as where a computer controls a step in the operation of a production process. To add to the complexities. there is, for instance, the possibility that principles which might be written into programs are instead given expression in the circuitry of the computer, and the possibility of writing programs that will bring about the co-operation of a network of computers.

4.7.5 Whether software is a "process' or not can be judged from the litigation that existed in the developed countries on the issue whether a particular software can be patented or not. In all these cases, it was argued that an invention in the form of a technical process was developed. Some of these cases are as below:- -

i. *(Koch and Sterzel : Program governing the operation of a technical device). A claim to X-ray apparatus controlled by a computer program so as to secure optimal exposure without overloading the X-ray tube was held patentable by an EPO Board of Appeal. It sufficed that 'technical means' were involved as well as the mathematical method or algorithm, which was characterized as 'non-technical'. It was not necessary to show that invention lay exclusively or largely in the former domain.*

ii. *Victom's Application: (Computer operating program in a industrial technique). A claim is patentable to a computer so Programmed (or provided with hardware) as to be able to process digital images in accordance with a given mathematical procedure expressed as an algorithm. The program had been developed for computer aided design (CAD) of engineering and similar products, and the application was upheld once the claim was amended so as to cover only uses which started with a computerized image; the original claim was for less specific methods of using the algorithm. The claim was* *accepted because it was directed to a 'technical process'. At root, what mattered was that CAD is a widely used and most valuable aid to product design.*

iii. *Merrill Lynch's Application : application program for analyzing data). The claimed program could be used in an automated market for shares and similar securities. It analysed customer's orders to buy and sell against given criteria; those which met the criteria were then carried out. The Court of Appeal held this unpatentable under the 1977 Act. The program could be introduced into any suitable computer in any encoding language, causing data to be acted upon so as to carry out legal transactions, rather than technical production in any ordinary sense.*

iv. *Gale's Application : new method of calculation). The applicant's essential discovery was of a method of calculating square roots in the binary functioning of a computer by eliminating division and restricting multiplication to specified binary functions. This could be given form in the electronic circuitry of a read-only memory (ROM) and the claim was to a ROM carrying the relevant controls. Aldous J. was prepared to accept the claim; but the Court of Appeal refused the application for its very apparent reference to mathematical procedures for producing numbers. The Court refused to accept in such a case that embodiment in a ROM made to program patentable, where it would not be if expressed purely in mathematical terms or was contained on a floppy disk for insertion in a computer.*

4.7.6 The distinction between the securing of a technical effect in the `nature of a new invention and the mere production and manipulation of information has been made for the purpose of deciding patentability but the fact remains that all these software involve a process, the term which is much wider in scope than patent It was introduced in order to confine the exclusion of computer programs as such within a limited compass, itself an approach founded on a belief that the patent system should be open to 'innovative technology' in a broad sense. Programming include specialized skills such as mathematical procedure for the calculation of square roots; the conversion of binary decimal numbers into pure binary numbers the compilation of a source program in high-level language into object code, whether a number is a prime number or not. Such concepts and combinations of them represent technical know how. Networking of computers, which are linked together physically, the program instructions which bring about the efficient co-operation of the various stations has the 'feel' of larger technology.

4.7.7 In view of the above discussion, it is held that software is a process used by a computer to achieve a desired result.

4.8. ***Whether "a similar property"***

4.8.1 Clauses (i) and (iii) of the explanation 2 to section 9(1)(vi) defining 'royalty' use the term "a similar property". It means a property which is similar to a patent, design, trademark, secret formula, process etc. Let us discuss what these terms mean and what is common about all of them.

4.8.2. ***What is a patent?***

If you have invented something, you can get a patent to protect it. A patent is a document which gives you the right to stop other persons from making, copying, using or selling your information. Patents are the oldest and strongest form of intellectual property. There is a rigorous examination procedure where the scope of the patent claims is tested, and searches are made for anticipation of the invention by others.

4.8.3. ***What is a design?***

If you have created a new design (a new shape, form or appearance of an article), you can protect your design by registering it. There are two different types of designs which can be registered. i.) An aesthetic design - just for the beauty of the shape configuration or ornamentation. ii.) A functional design, where the shape, configuration is necessitated by the function.

4.9.2 The Second Proviso to section 9(1)(vi) of the Act itself state as under:

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

4.9.3 It shows that when computer software is acquired along with equipment, then consideration paid for the software will not be royalty if the agreement is approved by the specified authority of the Govt of India. In other words, if the agreement is not approved then payment for acquisition of such software would be taxable. It is also important to note here that the legislation has not used the word "copyright" as used in clause (iv) of the explanation defining royalty. In this regard, circular no 621 dated 19/1211991 issued by the Central Board of Direct Taxes explains the circumstances as under -

34.3 At present, the value of software in a physical form such as magnetic tape or disc imported into India is subjected to custom duty on the ground that what is imported is commodity. <u>At the same time. since import of software is generally under a license from the foreign licensor, the lump sum payments made for using the software are regarded as payment of royalty within the meaning under Explanation 2 of section 9(1)(vi) of the Income-tax Act and taxed accordingly</u>.

34.4 In order to prevent this dual levy, the Income-tax Act has been amended to provide that any lump sum payment for obtaining use of systems software supplied by a non-resident manufacturer along with the computer hardware will not be subjected to income-tax. This tax concession will not be available in relation to payments in respect of system software imported otherwise than under an approved Computer Software Export Scheme or where the software is supplied separately or independently of the computer hardware even though the software has been developed or marketed by the supplier of the computer hardware.

4.9.4 This position was again reiterated in circular No.794 of 2000 as under:

7.1 Under the existing provisions, section 9 lists the income that is deemed to accrue or arise in India, However, any royalty income in the hands of the non-resident manufacturer received from a resident person or the Government for the transfer of rights in respect of computer software along with a computer or computer-based equipment under an approved scheme is excluded from the deeming provisions of section 9.

This circular was intended to remove any doubt that a software supplied with a license in India will be taxable as royalty under section 9(1)(vi) of the Act.

4.10. Sub section (IA) of section 115A of the Act

4.10.1 Further, taxability of income of import of software has been amply clear in the Income Tax Act through sec. 11 5A (which deals with tax on dividends, royalty and technical services fees in the case of foreign companies) wherein it has been provided under (1A) as under:

"Where the royalty referred to in clause (b) of sub-section (1) is in consideration for the transfer of all or any rights (including the granting of a license) in respect of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India, the provisions of sub-section (1) shall apply in relation to such royalty as if the words the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy occurring in the said clause had been omitted."

4.10.2 Section 115 provides rates of tax in respect of royalty, FTS, .dividend and interest payments to non-residents. It may be noted that different wordings have been used in the subsection (IA) for books and for software. In case of books, it says payment for transfer of 'any right in respect of copyright' whereas in case of software it simply says transfer of 'any right in respect of software'. The word copyright has not been used in the case of software. Rightlyso, as discussed earlier, a book is a tanalble property whereas software is an intannible property. As per section 9(1)(vi) defining royalty, in case of Intangible property consideration for mere use of such property will be in the nature of royalty whereas in case of tangible property (other than equipment), royalty would arise only for transfer of copyright right.

4.10.3 Section 80HHE was introduced in the Act w.e.f 1.4.1991 for granting deduction in respect of profits from export of software. The need arose mainly because such profits were not entitled for deduction u/s 80HHC as the software was not considered as goods or merchandise.

4.11. ***Meaning of Copyright***

4.11.1 If you create an original work that people can see or hear, you can get copyright. Having copyright means that you own that work and you can control its commercial use. Your copyright can protect your work from being copied or reproduced without your permission. If you have an original idea, you cannot have copyright in it. You must put your original idea into a physical form, such as a book, a card, a CD, a painting, a picture, a screenplay or a film.

4.11.2 Authors of creative works in respect of such works and by reason of their creation, enjoy a right of exclusive ownership vis-â-vis all ¼ 'other persons, referred to as "copyright", the protection of which shall be organized by the law. According to the Copyright Act,1956 of India, copyright exists in a work (section 13). The 'work' has been defined under section 2(y) as literary, dramatic, musical or artistic work, a cinematographic film and a sound recording. The 'computer Program' has been defined under section 2(ffc) as a set of instructions expressed in words, codes, schemes or in any other form capable of causing a computer to perform a particular task or achieve a particular result. Section 2(o) of act specifies that literary work includes computer programs. tables and compilations including computer databases. "Copyright under section 14 means the exclusive right subject to the provisions of this act, to do or authorise 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 Program,

(i) to reproduce the work in many 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 transaction of the work;

(vi) to make any adaptation of the work;

(vii) to do, in relation or an adaptation of the work, any of the acts specified in relation to the work in sub-clause (i) to (vi).

(b) in the case of a computer Program:

(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 Program:

PROVIDED that such commercial rental does not apply in respect of computer programs where the program itself is not the essential object of the rental.

4.11.3 That means the owner of the copyright in a computer software has now 8 rights instead of conventional 7 rights [as per clause (a) of section 14 (supra) 1. Even right to sell or giving on commercial rent is included in the software. In the A.A.R. case of Factset Systems (AAR No.787 of 2008) these rights appear to be not considered, It may be worthwhile to .point out that, similar rights were also introduced in the US Copyright Act. Sec. 109A of the US Copyright Act [as amended in 1990] states:

"Notwithstanding the provisions of the Sub-sec.(a), unless authorised by the owners of the copyright in the sound recording or the owner of copyright in the computer Program (including any tape, disk or other media embodying such Program), and the case of sound recording in the musical works embodied therein, neither the owner of the particular phonorecord nor any person in possession of a particular copy of a computer Program (including any tape, disk or other media embodying such Program), may for the purpose of direct or indirect commercial advantage, dispose of, or authorise the disposal of the possession of that phonorecord or computer Program (including any tape, disk or other media embodying such Program), by rental, lease, or lending, or by any other Act or practice in the nature of rental, lease or lending. Nothing in the preceding sentence shall apply to the rental, lease or lending a phonorecord for non-profit purpose by a non-profit library or non-profit educational institution."

From the above it can be seen that in the present case, a user of the computer software in India has obtained a copyright right of the assessee i.e. right to use on commercial hire. Thus, payment for acquisition of software by it is also consideration for transfer of any right in respect of copyright in software. Thus the argument of applicant that the Copyright Act is not applicable is not the correct position.

4.12. ***Whether sale of "Copyrighted Item" or transfer of "Copyright Right"?***

4.12.1 It is argued that software acquired is a copyrighted item and not the copyright right. For instance in the case of a book, when the books are sold, it is the sale of copyrighted item but when a right to copy is given to a distributor who in turn makes copies and sales books, it is said that the distributor has acquired a copyright right. The payment for copyright right is royalty and not for copyrighted item.

4.12.2 The above statement is correct when we are dealing with tangible properties like books, paintings, model etc because these are the end products in themselves. This is not correct in the case of intangible properties like software, designs etc. Royalties are two types - copyright royalties and know-how royalties. In case of later, the payment for mere use would qualify as royalty. For instance standardized design for *construction of a particular type of bridge. The developer only gives a right to use to the payer. The design is given in the form of a booklet with detailed drawings etc. It is in the physical form but it does not qualify as a tangible property or a copyrighted item. It comes under the know-how royalty. Similar is the case of software. Even the standardized software will fall under the category of know how royalty.*

4.12.3 If it is presumed that software on carrier media disks or tapes is an copyrighted article and not an intangible property, then sale of software on a CD will not be royalty but if the same software is downloaded on internet with the permission of developer, it would not be an article. Consequently it would be in the nature of royalty. It would be a totally untenable interpretation which changes taxability of a payment for acquisition of the same property on the basis of method of delivery. Such an interpretation cannot be accepted.

4.12.4 At this juncture, it would be appropriate to borrow from the Commentaries by Eminent Authors before arriving at a finding in this matter. OECD Commentary vide para 15 states that where consideration is paid for the transfer of the full ownership, the payment can not represent a royalty and the provisions of the article are not applicable. Difficulties can arise where there are extensive but partial alienation of rights involving -

- *exclusive right of use during a specific period or in a limited geographic area;*
- *additional consideration related to usage;*
- *consideration in the form of a substantial lumpsum payments.*

Reference to Klaus Vogel's Commentary on Double Taxation Conventions shows that in Canada, payment for using of software by virtue of contract, where the Program is kept confidential, amounts to payment for use of secret formula and hence amounts to royalty payment. A similar view is taken in United States as referred to in para 29 of the Commentary by Vogel which states as under:

"29. The United States believes that in interpreting the definition of 'royalties' in para 2 of the article, with respect to payments for software, it should be understood that where a payment for the acquisition of software for the personal or business use of the purchaser is measured by reference to the productivity or use of such software, the payment may represent a royalty under the article." [Para 36b]

Relevant paras from Vogel's Commentary at P.783 (2005 edition, Indian reprint 2007) are reproduced below:

12. "[Consideration for software] Whether payments received as consideration for computer software may be classified as royalties poses difficult problems but is a matter of considerable importance in view of the rapid development of computer technology in recent years and the extent of transfers of such technology across national borders. Software may be described as a program, or series of programs, containing *instructions for a computer required either for the operational. processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing, on a magnetic tape or disc, or on a laser disc. It may be standardised with a wide range of applications or be tailor made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware. The rights In computer software are a form of intellectual property. Research into the practices of OECD Member countries has established that all but one protect software rights either explicitly or implicitly under copyright law. Transfers of rights occur in many different ways ranging from the alienation of the entire rights to the sale of a product which is subject to restrictions on the use to which it is put. The consideration paid can also take numerous forms. These factors may make it difficult to determine where the boundary lies between software payments that are properly to be regarded as royalties and other typos of payment".*

4.12.5 Several important points have been considered while coming to the conclusion that supply of software by the assessee will be chargeable to tax as Royalty. The definition of copyright as per Sec.14(b) of the Copyright Act, 1957 with regard to software has been considered. The perusal of this definition clearly indicated that in the case of computer programmes, selling or giving on hire of the software or offering for sale or for commercial rental any copy of the computer programme regardless of whether such a copy has been sold or given on hire on earlier occasion constitute the grant of a right to use copyrights. The said definition makes it clear that copy of legally obtained software constitutes grant of exercise of the copyright. Article 3(2) of the Indo-US DTAA makes it mandatory to adopt the definition of the word 'copyright' as given in the law of the state applying the provisions of the treaty and therefore, definition as given in Indian Copyright Act, 1957 shall be applicable in the present case. Neither Indian Copyright Act, 1957 nor any Circular issued by the CBDT makes any distinction between Copyright and Copyrighted article and such distinction made in US regulations cannot be extended to Indian territories and only laws promulgated by the Indian sovereign have to be applied. Further, the 'Royalty is a very wide term under the Income Tax Act and under the DTAA and it covers other aspects of the intellectual property also besides the transfer of the copyright right like process, equipment covered by explanation 2(iva) to sec.9(1)(vi).

4.13. ***Conclusion under Domestic Law***

4.13.1 It is an admitted position of law that when the owner of any Intellectual Property (IP) licenses it (the IP) to others for use and/or exploitation, he charges a fee, which is called Royalty. Copyrights, patents, designs, trademarks, formula, process, commercial! scientific knowledge etc, are all classic forms of intellectual property rights and which have been mentioned in the definition -of Royalty. However, with the advent of modern technology, software has now been added to this *list of IPs. As there is no doubt that software are IPs, consideration paid for the license to use the software (even though these do not specially appear in the definition of Royalty) should, by first principle, fall under the category-Royalty. To sum up*

a) Software is not goods or tangible property but intangible intellectual property.

b) Software is 'process" as mentioned in clause (I) and (iii) of the explanation 2 defining royalty.

c) Alternately, software is a property similar to patent, invention, design, secret formula, process etc.

d) The CBDT in circular no 621 of 19/1 2/1991 .has categorically stated that payment for acquisition of software under a license is royalty. The intention of the legislation in subsequent amendments i.e. second proviso to sec 9(1)(vi), sect 11 5A(1 A) and 8OHHE is clear in this regard.

4.13.2 In view of the above, it is held that payment made by the assessee for use, or right to use software is in the nature of royalty liable to tax in India under domestic law.

4.14 ***Conclusion under treaty law****:*

4.14.1 The term 'royalty' has been defined in a different way under most of the double tax avoidance treaties India has with different countries. The definition of royalty as per Article 12(3) of Indo-USA treaty is as under -

(a) payments of any kind received as consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, 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, including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof; 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 payments derived by an enterprise described in paragraph I of article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of article 8.

4.14.2 Basic structure of the term royalty in the treaty is same as in the domestic law. For instance it refers to the following categories which are also there in domestic law-

i) patent, trademark, design or model, plan, secret formula or process

ii) information concerning industrial, commercial or scientific experience *ii) industrial, commercial or scientific equipment*

iv) literary, artistic, or scientific work, including cinematograph films.

4.14.3 Similar to domestic law, mere use of first three categories is royalty and in the case of fourth category it is the copyright right. The minor differences are-

i) In case of first category, instead of 'transfer of any right', the treaty uses the word "right to use"

ii) The treaty uses specific words 'copyright of literary, artistic or scientific work' whereas domestic law says "copyright, literary, artistic or scientific work".

iii) The treaty does not use the word a similar property".

iv) There is a comma after the phrase 'secret formula or process" which is not there in the domestic law using the same phrase as "secret formula or process or ....". It means the word secret should also be applied to the word process. So, to qualify as royalty it should be a secret process.

4.14.4 The above differences do not change the position in respect of software once they are classified as process. They are also secret because the source code is not given to the user. The use of secret process implies use of a process which is secret i.e. not available in public domain. It is not necessary that the secret should be divulged to the user. In the present world of technology, it is possible to allow others to use a process without disclosing the secrecy of the process. - For instance, the working of a software which can determine whether a number is prime number or not, is a secret process. The user of such software uses the process without knowing how the software works. Thus the payment for use of software is for use of a secret process. Consequently, the payment would be in the nature of royalty.

4.15 Thus income relatable to the supply of software under the present contract answers to the description of royalty, as the software in question are copyrights which have been given to Reliance Communications Ltd., for use. Since the provisions of the Act and the DTM are very clear on this point, no reference to the Copyright Act or to any other source appears necessary.

4.16 Without prejudice to the fact that use of software program on computer will amount to transfer of copyright under section 14 of the Copyright Act, the payment will also be covered as the payment for use of secret process. Further, the software in general is an intellectual property and allowing its use by sale or by renting is covered by Royalty.

4.17.1 The impact of introduction of explanation 2(iva) to set 9(1)(vi) was lucidly considered by the Hon'ble ITAT, Hyderabad and it held in case of M/S Front tine soft Limited ITA no 1080-1O81/Hyd/03 held vide para 22,23,24 and 27 as below:

22. We have heard the (earned representatives of patties and record perused. The issue to be examined under consideration is whether impugned payment made to TDT against purchases of software or payment of Royalty. After elaborate discussion on the issue while deciding the first ground we find that what is taxed as royalties is the amount paid as consideration for the use or the right to use and not outright purchase or the fight to use as an asset Royalty is thus consideration for the transfer of all or any right including the granting of a license in respect of a copyright, patent, trade mark, design and modal or secret formula, the use or right to use any industrial, commercial or scientific equipment (section 9(1)(vi), explanation 2. (iva)) transfer of the 'fight in the property' is not the subject matter. It is the transfer of the 'fight in respect of the property'~ The two transfers are distinct and have different legal effects. In one right are purchased which enables use of those fights, while in the other the purchase is involved, only the right to use has been granted. Ownership denotes the relationship between a person and an object forming the subject matter of his ownership. It consists of a complex of rights all of which rights are tights in pm petty being good against all the world and not merely against a specific person and such rights are indeterminate in duration and residuary in character. That sum may be agreed for the transfer of one right, two rights and so on but not the ownership. Thus, the definition in respect of software etc. does not extend to the outright purchase of the right to use an asset A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and therefore, not royalty. In an outright transfer to be treated as sale/purchase of property as opposed to license, alienation of all rights in the properly is necessary. This distinction has been recognised and given effect to in the following judicial pronouncements.

1) CIT. Vs. Davy Ashmore India Ltd (1991) 190 ITR 626 (Cal) = (2OO3-TIOL-2O7-HC-KOL-IT)

"The term 'royalty has been defined in the Agreement to mean, inter alia, the payment of any kind including rentals received as a consideration for the use of or the right to use any patent, trade mark design or model, plan, secret formula or process. It is important that, in order that a payment may be treated as royalty for the purposes of article XIII of the agreement for avoidance of Double Taxation between India and the U.K., the person who is the owner of such patents, designs or models, plans, secret formula or process, etc., retains the property in them and permits the use or allows the right to use such patents, designs or models, plans, secret formula, etc. In other words, where the transferor retains the property right in the designs, secret formula, etc. and allows the use of such right, the consideration received for such user is in the nature of royalty. Where, however, there is an outright sale or purchase, the consideration is for the transfer of such designs, secret formula. etc., and cannot be treated as royalty." (relevant headnote)

2) C.I.T. Vs Ahmedabad Mfg. & Calico Printing Co. (1983) 139 ITR 806(Guj) = (2003-TIOL-210-HC-AHM-IT)

"In the case of secret processes, patents, special inventions, when right of exploitation is given by the owner of the inventions, patents etc., to a third party instead of outright sale, then for the right to exploit these inventions, secret processes, some amount may be paid and the amount paid may be correlated to the extent of exploitation. It is in this '~ sense that license agreements for the exploitation of patents, inventions, etc. are being entered into in modem commercial would and as part of such agreements, even knowledge derived from his own experience and technical know-how for the most economical and efficient user of the patents, inventions, etc. are parted with by the licensor to the license. Payments of this kind are known as royalties. This is also evident from several double taxation avoidance agreements between the Govt. of India and foreign countries such as Sweden in which the term 'Royalty' has been defined. That such payments are royalties is also evident from the definition of the word 'Royalty' in section 9(1)(vi), Explanation 2, which was subsequently introduced by the Finance Act, 1976, with effect from June 1, 1976) (Relevant head note)."

23. In OECD commentary it is stated that the character of payments received in transactions involving the transfer of computer software depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the pro gram. The rights in computer programs are a form of intellectual property. Research into the practices of OCED member countries has established that all but one protects rights in computer programs either explicitly or implicitly under copy right law. Although the term 'computer software' is commonly used to describe both the program in which the intellectual property rights (copy right) subsist and the medium on which it is embodied, the copyright law of most OECD member countries recognises a distinction between the copyright in the program and software which Incorporates a copy of the copyrighted program. Transfer of rights in relation to software occur in many different ways ranging from the alienation of the entire rights in the copyright in a program to the sale of a product which)~ subject to restrictions on the use to which it is on the use to which it is put The consideration paid can also take numerous forms. These factors may make it difficult to determine where the boundary lies between software payments that are properly to be regarded as royalties and other types of payment The difficulty of determination is compounded by the case of reproduction of computer software, and by the fact that acquisition of software frequently entails the making of a copy by the acquirer in order to make possible the operation of the software. Various countries have given different treatment of royalties despite OECD recommendation. Indian DTAAs already contained pro visions for taxing equipment rental as royalties, but domestic law did not have specific provisions till 2002-03. The Finance Act 2001 inserted clause (iv) (a) in sections 90) (vi), Explanation 2 to bring about a result diametrically opposite to the OCED recommendations. The said clause is reproduced as below:

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

24. Where the domestic law is clear, unambiguous and does not suffer from any void or gap, the spirit or intention of international convention, under no circumstances, can override the express provisions of domestic law.

…….

26. With the above background of discussion now we examine the facts of the case under consideration, we find that in the impugned transactions of payment to TDT was for the use of 'True Dial Software' and not for purchases, as evident from following clauses of terms and conditions of the agreement:

…….

27. From above terms and conditions we find that the said payment was not for transfer of absolute assignment and ownership of "True Dial Software" The transaction clearly, falls under the definition of 'Royalty' as defined in section 9fl)(vi) Explanation 2 (iva). The assessee acquired only right to use of 'True Dial Software". It is 'Royalty' and royalty payment to NRI is deemed to accrue and arises in India and therefore, payment is subject to tax deducted at sources. We them fore, confirm the orders of the lower authorities.

*4.17.2 Recently **Karnataka High Court in CIT vs. Samsung Electronics Co. Ltd. (2009) 185 Taxman 313 (Kar)** held that for the import of software the tax as 'Royalty" has to be deducted and answered in para 90 of the order Q.No. 2, 3, 4 as below:*

Sr. No.	*Substantial questions raised*	*Answers*
1	*……..*	
2	*Whether the Tribunal is correct in holding that the payments made by the Assessee Company for <u>purchase of software</u> from Aaymetrix Asia Pacific, Singapore; Peritus Software Service Inc., USA and Astral Computers Pvt. Ltd., Singapore for the amounts of Rs. 3,43,095, Rs. 47,89,419 and Rs. 8,89,611 <u>was not liable</u> to Income-tax in India and consequently no TDS as held by the Assessing Officer and confirmed by the Appellate Commissioner needs to have been deducted?*	*Not correct. In the negative. against the assessee and in favour of the Revenue*
3	*Whether the Tribunal was correct in merely following the judgment passed by it in the case of Samsung Electronics Co. Ltd. which has not been accepted by the Revenue and*	*Definitely wrong, answered in the negative, against the assessee and*

	appealed against before this Hon'ble Court where the facts were not entirely identical to one subsisting in the present case and therefore the Tribunal was bound to have recorded an independent finding and therefore the impugned order is perverse?	*in favour of the Revenue*
4	*Whether the Tribunal based on the fact that the Assessee has imported software from Aaymetrix Asia Pacific. Singapore; Peritus Software Service Inc., USA and Astral Computers Pvt. Ltd. Singapore on payment of Rs. 3,43,095, Rs. 47,89,419 and Rs 8,89,61! was bound to have taken into consideration the Ruling of the Advance Ruling Authority (238 ITR 296); the Double Taxation Agreement between India and (1S4 and India and Singapore, provisions of section 9(1)(vi) of the Income-tax Act; Indian Copyright Act, 1957. the Revised entry on Article 12 of OECD; the internal Revenue Service Regulation of USA; the Views of the High Powered Committee on Commerce and other facts and circumstances of the present case which could have clearly shown that the payments made by the Assessee was liable to tax in India and consequently the Assessee was bound to be answered in the negative, against the assessee and in favour of the revenue In the against assessee favour revenue negative, the and in of the to deduct tax at source?*	*In the negative, against the assessee and in favour of the Revenue*

22. This order of AO was passed with the approval of DRP, Mumbai. Hence assessee Lucent preferred the four appeals to ITAT. The grounds raised by Lucent common to all years are as under:

GROUNDS OF APPEAL

*"**1**. That on the facts and circumstances of the case and in law, the Additional Director of Income Tax (International Taxation), Range-4, Mumbai (hereinafter referred to as "the Learned AO") has erred in computing the income of the appellant of Rs.30,72,21,521 and raising a consequent tax demand of Rs.6,45,16,519 and interest demand of s.10,01,61,895 for A.Y. 2003-04, while issuing a single assessment order for A.Y. 2003-04, A.Y. 2004-05, A.Y. 2005-06 and A.Y. 2007-08 dated 19 August 2010 and thereby not accepting the Appellant's claim for refund of Rs.4,60,83,230 alongwith interest.*

Taxability of Income

2. *On the facts and in the circumstances of the case and in law the Learned AO and the Dispute Resolution Panel (hereinafter referred to as "the DRP") have erred in holding that the amounts received by the Appellant from supply of software to Reliance Communications Limited (previously known as Reliance Infocomm Limited) (hereinafter referred to as "Reliance") are "Royalty" in nature under the provisions of the Act and under Article 12 of the Double Taxation Avoidance Agreement between India and USA (hereinafter referred to as "DTAA") and thus liable to tax in India.*

3*. On the facts and in the circumstances of the case and in law the Learned AO and the DRP authorities have erred in holding that Lucent Technologies Hindustan Private Limited becomes a permanent establishment (hereinafter referred to as "PE") for the Appellant in India.*

4*. On the facts and in the circumstances of the case and in law, the Learned AO and the DRP authorities have erred in holding that that the sale of software is effectively connected to the PE of the Appellant in India.*

5. *Without prejudice to the grounds 2, 3 and 4 above, the on the facts and circumstances of the case and in law, the Learned AO and the DRP authorities have erred in not holding that the payments received by the Appellant are not "Royalty" in nature and there is no PE of the Appellant in India and accordingly, the receipts of the Appellant are not taxable in India.*

Attribution of Income

6*. On the facts and in the circumstances of the case and in law the Learned AO and the DRP have erred in considering that entire receipts from supply of software to Reliance are attributable to the PE (as mentioned in Ground 3 above) and taxable as per Article 12(6) read with article 7(3) of the DTAA, thereby taxing the entire receipts from supply of software under section 44D read with section 115A (1) (b) (A) of the Act.*

7. *Without prejudice to ground 6 above (while assuming but not accepting the existence of a PE in India), the DRP authorities ought to have directed the Learned AO and consequently, the Learned AO ought to have proceeded to determine the income attributable to the operations in India and thereafter, compute and profits attributable to such income of the alleged PE in India (as the entire receipts from the sale of software are not taxable in India.)*

8*. On the facts and in the circumstances of the case and in law the Learned AO and the DRP authorities erred in taking a without prejudice argument that in the even at any appellate level, provisions of Article 12(6) are not considered to be applicable, then the receipts from supply of software to Reliance is to be taxable under Article 12(1)(2) of the DTAA.*

9. *On the facts and in the circumstances of the case and in law, the Learned AO and the DRP authorities have erred in taking a without prejudice argument that in the event it is held that where the receipts from supply of software to Reliance is not 'royalty' in nature, the business profits of the*

Appellant are to be computed on the basis of the activities of the PE in India thereby taxing the software receipt on net basis in India.

10. *Without prejudice to the above, the DRP authorities have erred and consequently, the Learned AO in arbitrarily estimating that 80% of the activities are carried out by the PE in India. Further the DRP authorities have erred in estimating an extremely high net profit rate of 40% on their own surmises and conjectures and the Learned AO has erred in consequentially giving effect to the directions of the DRP authorities thereby resulting in computing the profits attributable to the PE @ 32%, which is very high as compared to the actual activities carried out in India in relation to the supply of software.*

11*. Without prejudice to the above, the DRP authorities have erred in not appreciating that all the critical activities in relation to the sale of software were carried on by the Appellant outside of Indian and all risks resided outside of India and the Learned AO has erred in consequentially giving effect to the directions of the DRP authorities thereby resulting in higher amount of profits being attributed to the PE in India.*

12*. On the fact and in the circumstances of the case in law, the DRP authorities and consequentially, the Learned AO have erred in not considering and not taking cognizance of the profit attribution study filed before the DRP to substantiate the profit attribution ratio.*

13. <u>Non-granting of TDS Credit-</u>

i On the facts and in the circumstances of the case and in law, the DRP has erred in not directing and consequently, the Learned AO has erred in not granting credit of taxes deducted of Rs.4,60,83,230 based on original TDS certificates submitted alongwith return of income following the provisions of section 199 of the Act.

ii Without prejudice to the above grounds, on the facts and in the circumstances of the case, the Appellant contends that if the credit of TDS is not granted to the Appellant of Rs.4,60,83,230 the amount received by the Appellant (which is net of TDS) is to be considered as the income of the Appellant and not the gross receipts as disclosed by the appellant in the return of income filed.

<u>Levy of Interest</u>

14. *On the facts and in the circumstances of the case and in law the Learned AO and the DRP have erred in levying interest under section 234A of the Act.*

15. *On the facts and in the circumstances of the case and in law the Learned AO and the DRP have erred in levying interest under section 234 B of the Act.*

16*. On the facts and in the circumstances of the case and in law the Learned AO and the DRP have erred in directing to levy interest under section 234D of the Act if it is held at any appellate levels that interest under section 234A or 234B of the Act is not leviable.*

Penalty

> ***17***. *On the facts and in the circumstances of the case and in law the Learned AO and the DRP have erred in initiating penalty proceedings against the Appellant under section 271 (1)(c) of the Act."*

Ground no 1 is general in nature.

23. The learned counsel for Lucent, Sr. P.J. Pardiwalla summarised the issues as under: -

a) Whether proceedings under section 147 are valid
b) Whether the receipts can be considered as Royalty to be taxed as gross basis
c) If the same are Business profits, is there PE and how much to be attributed to PE
d) Credit for tax
e) Interest under varies provisions

23.1 With reference to the objection regarding reopening he referred to page 193 of the paper book and subsequent filing of ROI to submit that detailed objections are not dealt with by DRP. However there is no ground raised on the issue in appeal before us.

23.2 With reference to the issue of Royalty, he relied on the various decisions to support that the sale of software cannot be considered as Royalty. The learned counsel referred to the agreements before DRP to submit that the assessee, Lucent, sold only software to run the equipment and referred to the scope of work in the agreement (Clause 3.1). He referred to various terms to submit that the sale and supply was outside India, only goods were supplied at unit prices on fixed price basis and there is no separate license fee and this software is specified for running the equipment (equipment specific) and so part of supply of Network agreement. He referred to the main General Terms and Conditions and Assignment agreement to stress that the Lucent was acting for supply of hardware and software for Network establishment and the products are only sold. He relied on the decision of the Special Bench of ITAT in Motorola 95 ITD 269 (Del) wherein it was considered that supply of software cannot be considered as Royalty. It was also further submitted that the software supplied is custom work and no standard software agreement were entered into. He reiterated the principles laid down by the decision of Motorola (supra) which were in fact approved in the cases of: -

1) DIT vs Nokia Networks OY, 25 taxmann.com 225
2) Seimens Aktiengesellschaft 19 ITR (TRIB) 336 (Mumbai)
3) DIT vs Ericson AB 204 Taxmann 192.
4) Lucent technologies 28 SOT 98

He admitted that there is clear conflict in the decisions of High Courts of Karnataka and Delhi.

23.3 With reference to the arguments on PE it was submitted that the assessee, Lucent, acted independently. He referred to the arguments of the AO to submit that reliance on latter agreement is not correct as that agreement was also signed by Lucent in which payment obligations were restricted, but Indian company is not acting as an agent. He then referred to Article 5.4 of DTAA for terms of 'Agent', 'Force of attraction'. Since there is no fixed place PE and as nothing was brought on record by Revenue, there is no PE in India to the Lucent LLC, USA. He relied on the principles laid down in Motorola (supra) para 127, page 159, 124 and decision in the case of Western Union financial Services Inc 104 ITD 34 (Del). It was submitted that Indian company is not a subsidiary of Lucent and it has no authority to conclude agreements. It was submitted that as the group company may have a PE but the assessee Lucent does not have PE in India.

23.4 With reference to giving credit of tax, it was the submission that the issue is decided by the order in the case of Lucent technologies GRL LLC 45 SOT 311(Mum).

23.5 With reference to levy of interest under section 234B/C/D it was submitted that the TDS was made as per the directions of AO, so as the amount was covered by TDS provisions, no interest can be levied. Further, he relied on the decision of NGC Network 313ITR 186 of Hon'ble jurisdictional High Court to submit that levy of interest does not arise.

24. In response, the learned counsel for the Revenue supported the orders of AO/DRP. It was his submission that Lucent choose not to file ROI under section 139(1) and so it cannot claim any benefits. Proceedings under section 148 were initiated for the benefit of Revenue. He referred to the doctrine of election (written submissions) and relied on case law of K Sudhakar S Shanbagh Vs ITO 241 ITR 865 (Bom). It was the submission that the Lucent cannot claim any benefit which was not claimed by filing ROI in time.

24.2 With reference to the arguments on Royalty, Ld. Counsel relied on the submission made in Revenue appeal. It was the submission that the decision of Special Bench in the case of Motorola does not apply as the software was not supplied along with hardware, but separately by separate purchase orders from a different company, so the factual position is different. He reiterated the same arguments on use of copyright/use of equipment/ intangible equipment, etc.

24.3 With reference to the issue of PE, he reiterated the AO's arguments and referred to 'assignment agreement', clause 7.3.2 for commissioning of software and Indian company is responsible for installing and commissioning of the software along with hardware, so agency PE exists. He relied on the orders on the issue of attribution of profits and levy of interest.

25. We have heard the contentions in detail and perused the paper books, various case law placed on record. There is no dispute with reference to the fact that Reliance purchased various equipments for establishing network and acquired software from various sources on various agreements which generally are considered as End User License Agreements (EULA). It was submitted that the software supplied were standard software which could be supplied to any other person in Telecommunication business with wireless telecommunication network. Reliance was granted the right to use the software for its own business purpose and is permitted to validly use the software for its wireless network. Pursuant to the supply of software, the LTGL is obliged to provide product warrantee to ensure that all the software supplied are free from defects and deficiencies. The LTGL is also responsible

to provide service for correcting the defective software, providing software updates and updates without any additional consideration. It was submitted that LTGL has not provided any software management services to Reliance. As already stated above Lucent Technologies Hindustan Pvt. Ltd had entered into a wireless software contract with Reliance on 31.07.2002 as part of GTC contract. This contract was subsequently assigned to LTGL on 5th August, 2002. LTGL supplied software under this agreement. The Reliance approached the AO for payment without deducting taxes and in all the cases, taxes were withheld by Reliance as per the orders of the AO. It was the contention of the parties, considering the terms of the contract/agreement under which software were supplied to Reliance, the meaning of the term Royalty, Copyright and Copyrighted Article, the commentaries of OECD model and UN model tax conventions and various judicial precedents, it was the contention that the consideration received by the parties from Reliance is in the nature of business profit and not Royalty. In the absence of any Permanent Establishment of the respective suppliers in India, the said business profit/income on supply of software is not taxable in India. These contentions were more or less accepted by the learned CIT(A) in all the appeals preferred by the Revenue on the issue.

26. Many of the arguments regarding provisions of section 5(2), section 9(1)(vi), provisions of section 14 of Copyright Act and section 52(1)(aa) of Copyright Act, commentaries of OECD, provisions of DTAA with USA and other countries and arguments that software is 'goods' on the basis of the decision of the Tata Consultancy Services vs. State of Andhra Pradesh 271 ITR 401, all other judicial precedents raised before us were also examined and considered by the Hon'ble Special Bench of the ITAT, Delhi in the case of Motorola Inc., Ericsson Radio Systems and Nokia Corporation, 95 ITD 269 (Del). Therefore, we are not extracting the detailed submissions as we have already extracted the orders of the CIT(A), which accepted Reliance's contentions and order of the AO in the case of Lucent for the Revenue's stand. The Hon'ble Special Bench of the ITAT examined various contentions and held that those assessee companies were leading suppliers of the said communication equipments comprising both hardware and software.

Software could not be effective without hardware, which was also supplied together. The Special bench of the ITAT on those facts was of the view that the crux of the issue is "whether the payment is for copyright or for a copyrighted article". If it is for copyright, it should be classified as royalty both under the Income-tax Act and under the DTAA and it would be taxable in the hands of the assessee on that basis. If the payment is really for a copyrighted article, then it only represents the purchase price of the article and, therefore, cannot be considered as royalty either under the Act or under the DTAA. This issue really is the key to the entire controversy and they proceeded to address the issue. After noticing the definition of copyright as given in the copyright Act, 1957 in section 14 of the said Act and referring to the various clauses in the agreement entered into between the parties and after referring to the various judgments relied on, on behalf of the parties, it was held that the payment by the cellular operator is not for any copyright in the software but is only for the software, as such, as a copyrighted article. It follows that the payment cannot be considered as royalty within the meaning of Explanation 2 below section 9(1)(vi) of the Act. Further, it was held that the software supplied was a copyrighted article and not a copyright and the payment received by the assessee in respect of the software cannot be considered as 'Royalty' either under the Act or under DTAA. Recognizing the distinction between Copyright and Copyrighted Article, it was held that purchase of software along with hardware is purchase of 'copyrighted article' and no 'copy right' was involved.

27. This order of the Motorola(supra) on the said facts was approved by the Hon'ble Delhi High Court in the case of DIT vs Erickson AB 204 Taxmann 192 and also in the case of DIT vs Nokia Networks OY, 25 taxmann.com 225. In the above cases, the Hon'ble High Court was concerned with the income earned by the assessee as a result of supply of hardware and software under the supply agreement wherein such supplies were made overseas. In the case of DIT vs. Erickson AB 204 Taxman 192, Hon'ble Delhi High Court did not accept the argument that the software component of the supply should be assessed as 'Royalty' because the software was integral part of GSM mobile telephone system and was used by

the cellular operator for providing cellular services to its customers. It was embedded in the equipment and could not be independently used. It merely facilitated the functioning of the equipment and was integral part thereof.

28. There is no dispute with reference to the principles established by the Hon'ble Special Bench as approved by the Hon'ble Delhi High Court in the cases cited supra. However, what is to be noted in the above judgements is that the software was supplied along with hardware as part of equipment and there is no separate sale of software. Software was integral part of supply of equipment for Tele-communications in those cases. It is generally called embedded software.

29. The facts in the present case of supply of software to Reliance are that the software was supplied separately and not alongwith the equipments, eventhough the software was stated to be specific for certain equipments supplied by LTGL. The fact that there is separate agreement for supply of software not only with Lucent, USA but also from various other non-resident companies, for use in the Reliance Network by virtue of separate agreements do indicate that software is not supplied alongwith hardware. As seen from the copies of agreements placed on record, some agreements are only for purchase of license/ granting of license only. But majority of agreements are standard in their format, which was discussed by Ld CIT(A) in the case of agreement with Lucent. It was admitted that the software works on the hardware, but the supply was not integral part of purchase of equipment required/ nor embedded software. Therefore, the facts as stated before the Special Bench of ITAT and Hon'ble Delhi High Court are entirely different when compared to the facts before us almost in all the cases, where the software agreements are stand-alone agreements, not with purchase of equipment and not supplied along with equipment as embedded software. The delivery was separate, as stated in the form of CD's, mostly abroad and was installed in India separately. As already stated, the Lucent has not been supplying software as part of equipment purchased but as a stand-alone software agreement entered into as the 'end user license agreement'.

30. The issue of supply of software and granting of End user license agreement (EULA) was considered by the Hon'ble Karnataka High Court in the case of CIT vs. Synopsis International Ltd. 212 Taxman 454 (Kar).

> *"As is clear from the description of the agreement it is an end-user software license agreement. Clause 2.1 deals with grant of rights. It provides, Software License Synopsyis hereby grants licensee a non-exclusive, non-transferable license, without right of sub-license of use the licensed software and design techniques only in the quantity authorized by a licensee in accordance with the documentation in the use area. Licensee may make a reasonable number of copies of the licensed software for backup and/or archival purposes only. Merely because the words non-exclusive and non-transferable is used in the said license it does not take away the software out of the definition of the copyright. The word licensed software has been defined. Similarly, the words design, design technique is also defined. The word documentation is also defined and it is not in dispute what is granted is a license. Even if it is not transfer of exclusive right in the copyright, the right to use the confidential information embedded in the software in terms of the aforesaid license makes it abundantly clear that there is transfer of certain rights which the owner of copyright possess in the said computer software/programme in respect of the copyright owned. In terms of the DTAA the consideration paid for the use or right to use the said confidential information in the form of computer programme software itself constitutes royalty and attracts tax. It is not necessary that there should be a transfer of exclusive right in the copyright as contended by the assessee. The consideration paid is for rights in respect of the copyright and for the user of the confidential information embedded in the software/computer programme. Therefore, it falls within the mischief of Explanation (2) of clause (vi) of sub-section (1) of section 9 of the Act and there is a liability to pay the tax.*
>
> *For the purpose of section 9 which deals with income deemed to accrue or arise in India, under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not (i) the non-resident has a residence or place of business or business connection in India, (ii) the non-resident has rendered services in India. Therefore, the object is to levy tax on the income of a non-resident, if it has accrued or arisen in India and one such income is the income from royalty.*
>
> *All the appeals are allowed. Impugned orders passed by the Income Tax Appellate Tribunal, Bangalore Bench, is hereby set aside. The order passed by the Commissioner of Income Tax (Appeals) affirming the order passed by the Assistant Commissioner of Income tax, Circle 19 (1), Bangalore, with modification is restored."*

31. The Karnataka Hon'ble High Court in a batch of appeals, in the case of Samsung electronics and Other case(345 ITR494 Kar) , on being restored by the Hon'ble Supreme Court, has considered the issue which is as under: -

> *"The question which the High Court will answer is whether on the facts and circumstances of the case, the ITAT was justified in holding that the amount(s) paid by the appellant(s) to the firm of software suppliers was not royalty and that the same did not give rise to any income taxable in India and therefore the appellant was not liable to deduct any tax at source."*

On this question the Hon'ble Karnataka High considered and held as under:-

> *The assessee-company was engaged in the development of computer software and exported such software to its head office located in South Korea. During the assessment years 1999-2000 to 2001-02, the assessee imported software products from the U. S. A., France and Sweden. During the financial years 1998-99, 1999-2000 and 2000-01, relevant for the assessments years 1999-2000, 2000-2001 and 2001-02, the assessee made payment of Rs.2,28,960, Rs. 10,825 and Rs. 1,51,85,430 respectively for importing software from these companies. No tax was deducted at source in respect of such payments. The Assessing Officer held that the payment made by the assessee would constitute royalty under Explanation 2 to section 9(1)(vi) of the Act and relevant clauses of the DTAA with the U. S. A., France and Sweden and, therefore, there was obligation to deduct tax at source under section 195(1). This was confirmed by the Commissioner (Appeals) but the Tribunal set aside the order. On appeal, the High Court restored the order of the Assessing Officer. On further appeal, the Supreme Court remanded the matter to the High Court :*
>
> *HELD reversing the Tribunal:*
>
> *(i) U/s 9(1)(vi) of the Act & Article 12 of the DTAA, "payments of any kind in consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work" is deemed to be "*royalty*". Under the Copyright Act, 1957, a software programme constitutes a "copyright". A right to make a copy of the software and use it for internal business by making copy of the same and storing it on the hard disk amounts to a use of the copyright u/s 14 (1) of that Act because in the absence of such a license, there would have been an infringement of the copyright. Accordingly, the argument that there is no transfer of any part of the copyright and the transaction involves only a sale of a copyrighted article is not acceptable. The amount paid to the supplier for supply of the "shrink-wrapped" software is not the price of the CD alone nor software alone nor the price of license*

granted. It is a combination of all. In substance unless a license was granted permitting the end user to copy and download the software, the CD would not be helpful to the end user;

(ii) The provisions of the Double Taxation Avoidance Agreements (DTAA) prevail over the provisions of the Income-tax Act, 1961, if the provisions of the DTAA are more beneficial to the assessee. The definition of "royalty" is restrictive in the DTAA whereas the definition of "royalty" under the Act is broader in its content.

(iii) Under the DTAA with the U. S. A., the necessary ingredient to be satisfied to find out whether the payment would amount to "royalty" is that it is received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work. A literary work is entitled to copyright. In India, section 2(o) of the Copyright Act, 1957, defines "literary work" as including computer programmes, tables and compilations including computer database. Therefore, "computer software" has been recognised as copyright work in India also. The Legislature has treated literary work like books and other articles separately from computer software within the meaning of the "copyright" under the Copyright Act. ***There is a difference between a purchase of a book or a music CD because while these can be used once they are purchased, software stored in a dumb CD requires a license to enable the user to download it upon his hard disk, in the absence of which there would be an infringement of the owner's copyright****. (****TCS vs. State of AP*** *distinguished as being in the context of sales-tax);*

allowing the appeals,

that in the absence of any definition of "copyright" in the Act or the DTAA with the respective countries, in view of article 3 of the DTAA, reference had to be made to the respective law regarding the definition of "copyright", namely, the Copyright Act, 1957, in India, wherein it is clearly stated that "literary work" includes computer programmes, tables and compilations including computer databases. It was not disputed that payments had been made by the assessee to non-residents for having imported shrink wrapped software/off-the-shelf software. It was clear from the material on record that what was transferred was the right to use the software, an exclusive right, which the owner of the copyright, i.e., the foreign supplier owned and what was transferred was only the right to use copy of the software for the internal business as per the terms and conditions of the agreement. The right that was transferred was the transfer of copyright including the right to make copy of software for internal business, and payment made in that regard would constitute royalty for imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill. The payment for the right would *constitute "royalty" within the meaning of article 12(3) of the DTAA and the provisions of 9(1)(vi) of the Act. Tax had to be deducted at source on the payment.*

32. The Honble High Court of Karnataka considered and analysed the provisions of Income Tax, particularly section 9, in detail in the case of Synopsis(supra) from Para 19 to 27. The detailed discussion on the issue is as under:

19. From the aforesaid judgments it is clear, a distinction has been made between a transfer of a right in a copyright and transfer of a right in a copyrighted article. In view of the language employed in sub-clause (v) to Explanation 2, the question is not whether what is transferred is a right in a copyright or a copyrighted article. The real question is whether the consideration paid to the owner or a licensor of a copyright, for permission to use the software/computer programme is a consideration for transfer of any right in respect of a copyright and falls within the mischief of the definition of 'Royalty'. This is clear from the wordings in section 9 of the Act, which reads as under :-

"(1) The following incomes shall be deemed to accrue or arise in India:-

(vi) income by way of royalty payable by-

....

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

....

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

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

(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 of exhibition of cinematographic films; or

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

[Explanation 3. For the purposes of this clause, 'computer software' means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data]

....

[Explanation - For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,-

(i) the non-resident has a residence or place of business or business connection in India: or

(ii) the non-resident has rendered services in India."

20. Income by way of 'Royalty' is liable to tax. The second proviso to Clause (vi) makes it clear that any lump sum payment made by a resident for the transfer of all or any lights including granting of a licence in respect of computer software supplied by a non-resident manufacturer along with a computer of computer based equipment under any scheme approved under the Policy on Computer Software Export, Software Developments and Training, 1986 of the Govt., of India, would not constitute 'Royalty'. For the purpose of the said section, the computer software supplied by a non-resident to a resident falls within the definition of 'Royalty'. If the case falls under the proviso it is out of the definition of the 'Royalty'. Therefore, it is clear that the consideration paid for supply of a software by a non-resident to a resident is a software (sic. royalty) unless it falls within the section proviso.

21. Therefore, any computer software sold on the shelf falls under the; second proviso and the consideration paid thereon falls within the mischief of 'Royalty' as defined in the said proviso. It is in this background, we have to look into clause (v) of Explanation 2. Under Explanation 2, for the purpose of clause (v), '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"). In other words, one of the tests to be applied is whether the consideration : paid would fall within the definition of capital gains. If the consideration paid do not fall within the definition of capital gains and do not fall within the second proviso, *then the said consideration would be 'Royalty' for the purpose of this clause, as defined in Explanation 2.*

22. Similarly, clause (v) deals with copyright, literary, artistic or scientific work and the consideration for the transaction of all or any rights (including granting of licence) in respect of any copyright, literary, artistic or scientific work as 'Royalty'. Similarly, what is excluded from the definition of Royalty' are consideration for the sale, distribution or exhibition of cinematographic films. Whereas, it expressly states the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv) (iva) and (v) also constitutes 'Royalty'. For the purpose of this provision, any rights includes granting of a licence, it should be in respect of any copyright. It is not a right in copyright. Therefore, the words "in respect of assumes importance for the proper understanding of what the legislature meant in defining 'Royalty' as they have done in Explanation 2. The argument is that it is only the consideration paid for transfer of a right in the copyright, which would constitute 'Royalty' and any consideration paid for the transfer of a copyrighted article do not involve any transfer or right and therefore, it is outside the scope of 'Royalty' as appeared in Explanation 2. The said argument is based on the aforesaid two decisions referred to supra. In the entire discussions in the aforesaid two cases, the words used in Clause 5 namely, "in respect or, is not noticed and not discussed. It is well settled law that the legislature is deemed not to waste its words or to say anything in vain. A construction which attributes redundancy to the legislature is not acceptable except for compelling reasons. The Courts always presume that the legislature inserted every word thereof for a purpose and the legislative intention in that every word of the statute should have effect. The intention of the legislature is primarily to be gathered from the words used. The words of a statute are first understood in their natural, ordinary or popular sense and phrases and sentences are construed according to their grammatical meaning, unless that leads to some absurdity or unless is something in the context, or in the object of the statute to suggest the contrary. The right way is to take the words as the legislature has given them, and to take the meaning which the words given naturally imply, unless where the construction of those words is. either by the preamble or by the context of the words in question controlled or altered. In this context it is necessary to know the meaning of the words "in respect of used in the *aforesaid provision. In fact this phrase has been the subject matter of interpretation by the Apex Court as well as the High Court.*

23. The Apex Court in the case of Shahdara (Delhi) Saharanpur Light Railway Co. Ltd. v. Upper Doab Sugar Mills Ltd. and anotehr, reported in AIR 1960 Page 695, held as under:-

"We do not propose, however, to rest our decision on this narrow question of haulage from the station platform to point A, as in our view the assumption made above as regards the definition of terminals in S. 3(14) is not justified. The definition as has already been stated is in these words. "Terminals" includes "'charges in respect of stations, sidings, wharves, depots, warehouses, cranes and other similar matters, and of any service rendered thereat". Thus two classes of charges are included in the definition. The first is "charges in respect of stations, sidings, wharves, depots, warehouses, cranes and other similar matters." The second is "charges in respect of any services rendered thereat". Whether or not therefore any services have been rendered "threat" that is, at the stations sidings, wharves, depots, warehouses, cranes and other similar matters the other class of terminals in respect of these stations, sidings, wharves, depots, warehouses, cranes and similar other matters remain. A further question thus arises as regards the interpretation of the phrase "in respect of". Does it mean charges for the mere provision and maintenance of stations, sidings, depots, wharves, warehouses, cranes and other similar matters are the terminals or does it contemplate charges only for use of sidings, stations, wharves depots, warehouses, cranes and other similar matters? The words "in respect of" are wide enough to permit charges being made as terminals so long as any of these things, viz., stations, sidings, wharves, depots warehouses, cranes and other similar matters have been provided and are being maintained. The question is whether the import of this generality of language should be cut down for any reason. It is well settled that a limited interpretation has to be made on words used by the legislature in spite of the generality of the languages used where the literal interpretation in the general sense would be so unreasonable or absurd that the legislature should be presumed not to have intended the same. Is there any such reason for cutting down the result of the generality of the language used present here? The answer in our opinion must be in the negative. It is true that in many cases stations, sidings, wharves, depots warehouses, cranes and other similar things will be used and it is arguable that in using the words "in respect of" the legislature had such user in mind. It is well to notice however that the legislature must have been equally aware that whereas in some cases accommodation provided by stations will he used, in, some cases sidings will be used, in other wharves, in others warehouses and in other cases cranes, and in certain cases several of these may be used, in most cases there will be no use of all of these. From the practical point of view it is impossible to regulate terminate charges separately in respect of user of each of these several things mentioned. When therefore the legislature authorised the Central Government to fix terminals as defined in S. 3(14), the intention must have been that the terminals leviable would not depend on how many of these things would be used. It is also worth noticing that the user of a depot, warehouse and cranes would necessarily mean some service rendered "threat". If terminals did not include charges in respect of the provisions of depots, warehouses, cranes unless

these were used, there would be no need of including these in the first portion as they would be covered by the second part of the definition viz., "of any services rendered threat". For from being there any reason to cut down, the consequence of the generality of language used viz., "in respect of, there is thus good ground for thinking that the legislature used this language deliberately to cut across the difficulty of distinguishing in a particular case as to which of these things had been used or whether any of them had been used at all. Innumerable people corry goods over the Railways and many of them for the purpose of the carriage make use of the stations, sidings, wharves, depots, warehouses, cranes and other similar matters, while many do not. Though at first sight it might seem unreasonable that those who had not used would have to pay the same charge as those who had made use of these, it is obvious " that the interminable disputes that would arise between the Railway Administration and the Railway users, if the fact of user of stations, sidings and other things mentioned had to determine the amount payable, would be unhelpful not only to the Railway Administration but also to the using public. The sensible, way was therefore to make a charge leviable for the mere provision of these things irrespective of whether any use was made thereof. That was the reason way such wide words "in respect of was used. We are therefore of opinion that the words "in respect of" used in section 3(14) mean for the provision of and not "for the user of."

24. The High Court of Bombay in the case of Anusya Vithal v. J.H. Mehta, Addl. Authority Under Payment of Wages Act, bombay and another, reported in AIR 1960 (Bombay) 201 held as under :

"4. Another requirement of a payment to fall within the term "wages" is that it must be "in "respect of employment or work done in such employment." The expression "in respect of" means "attributable to" [see Asher v. Seoford Court Estates Ltd. [1950 A.C. 508, 526] or, if it is given a wider meaning, "relating to or with reference to" [see Tolaram Relumal v. State of Bombay (1955) 1 SCR 158 at P. 165: (AIR 1954 466 at p.499). The payment must, therefore, be attributable to employment, that is, engagement in work, or to work done. During the period of lay-off, the employer is not in a position to provide work and the employee cannot insist on work being provided or wages being paid to him. The employee is also not wider any duty to work for his master or even to present himself for work. He has to present himself for work if he desires to claim compensation (see S. 25E of the Industrial Disputes Act). But he has an option in the matter. If he remains absent, he will not be entitled to compensation, but he will not lose the right, which he possesses under the standing orders, of reinstatement when the normal working is resumed. The employer cannot insist, on his attendance and there is also no obligation upon 1dm to provide work or to pay wages even if the worker presents himself for work. In order to escape liability for compensation, the employer may provide the worker with alternative employment, but the worker is not bound to accept it. If he does not accept it, he will not be entitled to claim lay-off compensation, but he will not lose his right of reinstatement when the lay-off ends. The compensation for lay-off is, therefore, paid in respect of a period when no work is done and when in fact there is no liability on the employer to provide work and on the employee to do work. It is not paid as additional remuneration for work done previously. It cannot, therefore, be said to be attributable to the employment of a worker or to the work done by him. It is made payable in order to mitigate or

reduce the hardship caused by reason of unemployment or temporary loss of employment. Consequently, it cannot be said to be a payment "in respect of employment or work done in such employment."

25. The High Court Patna in the case of Commissioner of income tax vs. Chunnilal Rameshwar Lal, reported in AIR 1968 Patna page 364 held as under :

"It is well known that the expression "in respect of is of wider connotation than the word "in" or "on". Hence, a class of municipal tax, though not a tax on the premises or buildings, may nevertheless be a tax in respect of the premises or building used for the business. Hence, the payment of the impugned amount of Rs. 125 as professional tax under section 150A read with (section 82(1)(ff) of the Municipal Act is in substance a municipal tax in respect of the business premises, and is covered by clause (ix) of sub-section (2) of section 10 of the Income-tax Act. The assessee is entitled to get allowance for the same under section 10(1) of the Indian Income-tax Act, 1922. The Appellate Tribunal was right in giving allowance to the assessee for a sum of Rs. 125 paid by him under the Bihar and Orissa Municipal Act, 1922."

26. The Apex Court in the case of Union of India v. Vijay Chand Jain, reported in AIR 1977 SC page 1302 held as under:-

"4. The contravention alleged is of section 4(1) which prohibits, inter alia, sale of any foreign exchange. Foreign exchange as defined in section 2(d) means foreign currency. Under section 23(1B) any currency, security, gold or silver, or goods or any other money or property "in respect of which" the contravention has taken place is liable to be confiscated to the Central Government. The currency confiscated this case was Indian currency. The question is whether the Indian currency constituting the sale proceeds of foreign exchange seized from the respondent was currency in respect of which the contravention had taken place. The words "in respect of" admit of a wide connotation; Lord Greene M.R. in Cunard's Trustees v. Inland Revenue Commissioners (1946) 174 LT 133 calls them colourless words. This Court in S.S. Light Railway Co. Ltd. v. Upper Doab Sugar Mills Ltd. (1960) 2 SCR 926=(AIR 1960 SC 695) construing these words in section 3(14) of the Indian Railways Act, 1890 has held that they are very wide. It seems to us that in the context of section 23(1B) "in respect of" has been used in the sense of being 'connected with' and we have no difficulty in holding that the currency in respect of which there has been contravention covers the sale proceeds of foreign currency, sale of which is prohibited under section 4(1). The intention of the legislature is clear from the explanation to sub-section (1B) of section 23 which provides that "for the purposes of the sub- section properly in respect of which contravention has taken place shall include deposits in a bank where such property is converted into such deposits." If for this sub-section any property in respect of which a contravention has taken place includes deposits into which the property may be converted and can be reached even where the deposits are in a bank, it is not reasonable to think that the sale proceeds in Indian currency of any foreign exchange would be outside the scope of section 23(1B) and therefore not liable to be confiscated. In our opinion the High Court was wrong in quashing the order of confiscation which we consider valid and lawful"

27. The words "in respect of" denotes the intention of the Parliament to give a broader meaning. The words 'in respect of admit of a wide connotation, than the word "in" or "on". The expression "in respect of" "means attributable to" If it is given a wider meaning "relating to or with reference to", it has been used in the sense of being 'connected with'. Whether it is a fiscal legislation or any legislation for that matter, the golden rule of interpretation equally applies to all of them. i.e., the words in a statute should be given its literal meaning. In respect of fiscal legislation those words should be strictly construed. If those words are capable of two meanings that meaning which is beneficial to an assessee should be given. However, when the meaning of the words used are clear, unambiguous, merely because it is a fiscal legislation, the meaning cannot be narrowed down and it cannot be interpreted so as to give benefit to the assessee only. Then it would be re-writing the section, under the guise of interpreting a fiscal legislation, which is totally impermissible in law. When the legislature has advisedly used the words 'in respect of', the intention is clear and manifest. The said phrase being capable of a broader meaning, the same is used in the section to bring within the tax net all the incomes from the transfer of all or any of the rights in respect of a copyright. In a taxing statute provisions enacted to prevent tax evasion are to be given a liberal construction to effectuate the purpose of suppressing tax evasion, although provisions imposing a charge are construed strictly there being no apriori liability to pay a tax and the purpose of charging section being only to levy a charge on persons and activities brought within its clear terms. Therefore, the specific words used in a taxing statute, charging tax cannot be ignored. It is not the consideration for transfer of all or any of the rights in the copyright. Without transferring a right in the copyright it is possible to receive consideration for the use of the intellectual property for which the owner possess a copyright. Ultimately, the consideration paid is for the usefulness of the material object in respect of which there exists a copyright. Therefore, the intention was not to exclude the consideration paid for the use of such material object which is popularly called as copyrighted article. Even in respect of a copyrighted article the same is transferred, no doubt the right in the copyright is not transferred, but a right in respect of a copyright contained in the copyrighted article is transferred. Therefore, the Parliament thought it fit to use the phrase 'in respect of' as contra distinct from the word 'in' copyright. The meaning is clear, intention is clear, there is no ambiguity. Therefore, there is no scope for *interpretation of this expressed term inasmuch as in the context in which it is used in the provision. Any other interpretation would lead to the aforesaid provision becoming otiose.*

33. Interpreting the Sections of Copyright Act, the issue was further analysed as under in Paras 29 to 36.

29. The copyright Act, also do not define the word copyright in the definition section 2. However, Section 14, gives the meaning of "copyright". This section was substituted for the previous one by the Copyright (Amendment) Act of 1994. Section 14 insofar as it is relevant is extracted hereunder:

"14. 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 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 electronics 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 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-clause (i) to (vi)."

30. The object of a definition is to avoid the necessity of frequent repetitions in describing all the subject-matter to which the word or expression so defined is intended to apply. The Legislature has power to define a word even artificially. So the definition of a word in the definition section may either be restrictive of its ordinary meaning or it may be extensive of the same. When a word is defined to 'mean' such and such, the definition is prima facie restrictive and exhaustive whereas the word defined is declared to 'include' such and such, the definition is prima facie extensive. Although it is normally presumed that the Legislature will be specially precise and careful in its choice of language in a definition section, at times the language used in such a section itself requires interpretation. A definition is not to be read in isolation. It must be read in the context of the phrase which it defines, realising that the function of a definition is

to give precision and certainty to a word or phrase which would otherwise be vague and uncertain but not to contradict it or supplant it altogether. An interpretation clause is not meant to prevent the word receiving its ordinary, popular and natural sense whenever that would be properly applicable but to enable the word as used in the Act when there is nothing in the context or the subject matter to the contrary to be applied to some things to which it would not ordinarily be applicable. Even when the definition clause uses words of very wide connotation a line may have to be drawn so as to exclude categories obviously not intended to be included.

31. When a word has been defined in the interpretation clause, prima facie that definition governs whenever that word is used in the body of the statute. If Parliament in a statutory enactment defines its terms whether by enlarging or by restricting the ordinary meaning of a word or expression, it must intended that, in the absence of a clear indication to the contrary, those terms as defined shall govern what is proposed, authorised or done under or by reference to that enactment. But, where the context makes the definition given in the interpretation clause inapplicable, a defined word when used in the body of the statute may have to be given a meaning different from that contained in the interpretation clause. All definitions given in an interpretation clause are therefore normally enacted subject to the qualification "unless there is anything repugnant in the subject or context, or unless the context otherwise requires". Even in the absence of an express qualification to that effect such a qualifications is always implied. However, it is incumbent on those who contend that the definition given in the interpretation clause does not apply to a particular section to show that the context in fact so requires.

32. In this background it is pertinent to note the opening words of section 14. It expressly state that "for the purposes of this Act". The intention of the parliament in expressing the meaning of the word in that manner and not defining the said term in the definition section cannot be lost sight of. Further, the legislature has chosen to employ the word 'means' in defining the meaning of the word 'copyright' which again makes the intention very clear that the said meaning to the word "copyright" is restrictive and exhaustive. Then the further words, 'exclusive right subject to the provisions of this Act' further imposes a rider on the meaning of the word 'copyright'. Though the word used is "exclusive right", in section 30 of the Act, the Parliament has provided what are the rights which the owners of a copyright may part with. It expressly states the owner of

the copyright in any existing work may grant any interest in the right by licence in writing signed by him or by his duly authorised agent. Therefore, when if comes to the question of granting licence it need not necessarily be the exclusive right, a may be any interest in the right. Therefore, when the word 'copyright' has not been defined in the definition section of the Act and the meaning of the word 'copyright' is to be found in section 14 of the Act. it is only for the purposes of the Act. Even though under section 14 copyright means the exclusive right, that is also subject to the provisions of the Act. The intention of the legislature is unambiguous, clear. The meaning of the word 'copyright' cannot be read in isolation. It most be understood in the context of the aforesaid restrictions, limitations imposed by the Parliament by express words. Therefore, if would not be proper to assign the same meaning as found in section 14 to the word 'copyright' when it is used in another enactment. The interpretation clause is not meant to prevent the word receiving its ordinary, popular and natural sense whenever that would be properly applicable, but to enable the word as used in the Act, when there is nothing in the context or the subject matter to the contrary to be applied to some things to which it would not ordinarily be applicable. Therefore, while understanding the meaning of the word 'royalty' used in the Income-tax Act as defined in Explanation (2) to section 9(1) of the Income-tax Act the meaning assigned to the word 'copyright' cannot be literally superimposed in that provision. It has to be understood in the context in which it is used as well as it has to be understood in the ordinary, popular and natural sense in which it is understood. Moreover the Copyright Act is concerned with protection of an intellectual property right which is vested in the owner of the copyright and prevention of its infringement. That is why while defining the meaning of the word 'copyright' it is defined as meaning 'exclusive right' to reproduce the work in any material form including the storing of it in any medium by electronic means or to issue copies of the work to the public pot being copies already in circulation or to sell or give on commercial rental or other than for sale or for commercial rental any copy of the computer programme. The reproduction which is sought to be prohibited by the Act but for which the owner of the copyright could be put to an enormous loss. The said definition does not deal with the ordinary meaning of the word 'copyright' which includes the right to use the work. It is a negative right. If is not a right to do something but rather a right to restrict others from doing certain acts. It is in this context the word 'exclusive' has to be understood. When in the Act itself after using the word exclusive right in section 14, when it comes to the question of licence of a copyright, if need not necessarily be an exclusive right, but any interest in the right, the word exclusive has to be restricted firstly to the Act itself and secondly to situations which fall outside the scope of section 30 of the Act. Therefore, the expression 'copyright' used in the Act cannot be the same as used in the Income-tax Act. In the Income-tax Act, when the legislature advisedly used the word 'in respect of a copyright' it cannot be construed as a right in the copyright and assign the meaning assigned in the Copyright Act to the second explanation, line language in Explanation (2) explicitly makes it clear for the purpose of clause (vi) of sub-section (1) of section 9 royalty means consideration for transfer of all or any rights including the granting of a licence in respect of any copyright, literary, artistic or scientific work. Therefore, the word exclusive right used in section 14 of the Act do not fit into the meaning of the word 'royalty' in Explanation 2 because royalty means the consideration for the transfer of all or any rights including the granting of a licence which is certainly not an exclusive right or transfer of all rights in the copyright or literary work. Payments made for the acquisition of partial rights in the copyright without the transfer fully alienating the copyright rights will represent a royalty where the consideration is for granting of lights to use the programe in a manner that would, without such license, constitute an infringement of copyright. In these circumstances, the payments are for the right to use the copyright in the program i.e., to exploit the rights that would otherwise be the sole prerogative of the copyright holder. Therefore, to constitute royalty under the Income-tax Act it is not necessary that there should be transfer of exclusive right in copyright, it is sufficient if there is transfer of any interest, in the right, and also a licence and consideration paid for grant of a licence constitutes royalty for the purpose of the said clause in the Income-tax Act. It is in this background, the discussion whether the payment is for a copyright or for a copyright article would be totally irrelevant. He crux of the issue is whether any consideration is paid for any right, or for granting of licence in respect of a copyright. The word 'in respect of gives a broader meaning. It has been used in the sense of being connected with. When the legislature has advisedly used the words 'in respect of'. The intention is clear and manifest. The said phrase being capable of a broader meaning, the same is used in the section to bring within the tax net all the incomes from the transfer of all or any of the rights in respect of the copyright.

33. In the IT Act, computer software is defined in Expln. 3 to s. 9(1)(vi) to mean any computer programme recorded on any disk, tape, perforated media or other information

storage devices and includes any such programme or any customized electronic data. Though this definition holds good for the purposes of second proviso to s. 9(1)(vi), the ordinary meaning and understanding of computer software is no different. Computer programme as such is not defined under the I.T. Act. However, Computer programme is defined in the Copyright Act as follows:

"Computer programme means a set of instructions expressed in words, codes, schemes or in any other form including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result."

34. It is also worth mentioning that some routines may be written in assembly code, essentially a set of memories for object code which another program translates directly into that code. This is normally done when the programmer needs to drive the hardware directly, or where speed is required, as it gives very precise control over the program's operation. Once all sections are complete, they are fitted together to produce a complete version in source code, i.e., in human- readable form that gives the user as little information as possible about the details of the program (thus reducing the danger of copying), the source code is used as input for another program, the compiler. This compiles the program into object code, a machine-readable form which will have linked to it the standard pieces of code for the program to run as a stand-alone or executable file. This version will be run to test it, and any errors which are discovered will be fixed in the source code and the whole recompiled. The final process is to produce the documentation which the user will need to operate the program. The completed product is the package of object code version and documentation. A complex piece of software may well consist of a number of programs which are called by a master program as different functions are required. Some writers distinguish between programs (the specific executable code modules) and software (the complete set of programs plus documentation), 'Software' is thus used interchangeably for both of these unless the context otherwise makes clear.

35. The copyright subsists in a computer program. It is not only unauthorised reproduction but also the storage of a program in a computer constitutes copyright infringement. Copying a literary work (such as a computer program) includes storing the work in any medium by electronic means. Copying includes the making of copies which are transient or some other use of the work. Since in virtually every case the operation of a program in a computer involves the copying of the program within the computer, this will constitute reproduction. Whenever an object program is run on a

computer, it is thereby copied; and whenever a source program is compiled in a computer, it is thereby copied or adapted. A software licence can, therefore, be legitimately considered to be a copyright licence. A major difficulty arising out of the licence clause for users is that it will almost invariably restrict the licensee from transferring the software to any third party. This may result in difficulties if, for example, the licensee wishes to transfer his computer operations to a facilities management company the transfer will require the consent of the licensor and will provide an opportunity for the charging of an additional fee. Licences have up to how normally prohibited any copying of the program, except as necessary for use. This had the consequence that the user could not make backup copies of the program for security purposes, although some licenses specifically conferred a limited right to make backup copies.

36. Ultimately, what the end-user, who pays the consideration requires is, the benefit of the user of the intellectual property, whether for his personal use or for commercial use. Merely because the end-user is not permitted to make commercial use of a copyrighted article by means of re-production of copyrighted article, it would not take the case out of the provision. The user may be for personal use or for commercial use. The essence of the copyright is the usefulness of intellectual property embedded in such copyright. One of the ways of exploiting a copyright is by re-production for commercial use. But that is not the only use to which a copyright could be made use of. It could be used for their personal use and that is the reason why consideration is stipulated even for such personal use. Though the rights that are transferred in such a transaction may be limited as compared to transfer of a copyright for commercial use. In particular, a software or a computer programme is such a sophisticated goods that it may be sold of the shelf, it may be sold looking into the needs of the customer, it may be even prepared keeping the requirement of end-user in mind. In all these cases copyright as such is not transferred. It is not necessary for the end-user also. The end-user wants permission to have the benefit of such intellectual property in carrying on his business which is a commercial venture. It facilitates his business. It is for that he pays consideration. Without such transfer or permission, the end-user cannot use the said intellectual property. If he does it amounts to infringement. Therefore, the right to use the intellectual property in respect of which the owner or the licensor possess a copyright is also a right in respect of a copyright, though not in the copyright itself. Therefore, the

words used in the provision that transfer of all or any of the rights includes the right to grant license in respect of copyright includes such right to use the intellectual property in respect of which the owner or the licensor possess copyright. It falls within the mischief of the word 'royalty' as defined under section 9(1) (vi) of the Act.

34. Further the issue of granting License was analysed in Para 41 to 46 of the same judgement as under:

<u>What is a license?</u>

40. A licence is a grant of authority to do a particular thing. It enables a person to do lawfully what he could not otherwise lawfully do. A licence does not, in law, confer a right. It only prevents that from being unlawful which, but for the licence, would be unlawful. It amounts to a consent or permission by an owner of copyright that another person should do an act which, but for that licence, would involve an infringement of the copyright of licensor. A licence gives no more than the right to do the thing actually licensed to be done. It transfers an interest to a limited extent, whereby the licensee acquires an equitable right only in the copyrighted article.

41. Licences may be exclusive, or non-exclusive. Non-exclusive licence is not defined in the Act. The term 'exclusive licence' is defined in section 2, clause (j). It confers on the licensee and persons authorised by him, to the exclusion of all, other persons, including the owner of the copyright, any right comprised in the copyright in a work. A non-exclusive licence is the grant of authority to do a particular thing with no right of exclusion whatsoever. It never conveys, by itself, an interest in property. It merely enables a person to do that which he could not otherwise do, except unlawfully.

42. The owner of the copyright in any existing work may grant any interest in the right by licence in writing signed by him or by his duly authorised agent. Copyright is different from the material object which is the subject of the copyright. So, a transfer of the material object does not necessarily involve a transfer of the copyright. The copyright in a book, picture or other work is disconnected and distinct from the general property in the material book, picture or other object. Hence, the sale or other transfer of the material object does not, of itself, constitute a transfer of the copyright therein. An assignment carries with it the whole interest in the thing assigned, including the right of reassign, while a licence is personal and not assignable without

the grantor's consent. An exclusive licence is a leave to do a thing, and a contract not to give leave to anybody else to do the same thing, It confers no interest, or property in the thing but only makes an action lawful, which, without it, would have been unlawful.

43. A licence is a permission to do something that would otherwise be unlawful. The question arises, therefore, as to what legal permission is granted by a software licence. The answer is, briefly, that in some cases the licence will be a permission to use confidential information, and in virtually in all cases it will be a permission to copy a copyright work. If the software has been kept secret by the producer, or only supplied on conditions of confidentiality and has not been published too widely, then the software licence will be akin to a licence of confidential information or know-how. The owner or licensor of a copyright, has a right to grant permission to use the software or a computer programme, in respect of which they have a copyright, without transferring the right in copyright. It is one of the right of a copyright. owner or licensor. Without such right being transferred, the end-user has no right to use the software or computer programme. If he uses it, it amounts to infringement of copyright. For transfer of such right if consideration is paid, it is not a consideration for transfer of a copyright but for use of intellectual property embedded in the copyright, and therefore it is for transfer of one of those rights of the owner of the copyright. It is not a right in copyright but it is in respect of a copyright. When a copyrighted article is sold also, the end-user gets the right to use the intellectual property embedded in the copyright and not a right in the copyright as such. Therefore the mode adopted or the terminology given is not decisive to decide the nature of transfer. Ultimately, it is the substance which has to be looked into.

44. Therefore, it is necessary to look into the terms of the agreement entered into between the parties, as it would be purely question of fact to be decided on the basis of the intention of the parties as could be gathered from the written words used in the agreement. The relevant terms in the agreement between the parties is as under:-

"End user software License agreement

Between

Synopsys International Limited
Unit 1, Blanchardstown Corporate Park
Blanchardstown, Dublin 15
Ireland

And

Athena Semiconductors Private Limited
No. 1081, 12th Main Indiranagar
Bangalore - 560 038, India

1.3 "confidential information" means

(i) the Licensed Product, in object and source code form, and any related technology, idea, algorithm or information contained therein, including without limitation Design Techniques, and any trade secrets related to any of the foregoing.

(ii) Synopsys's proprietary knowledge database product SolvNet;

(iii) Designs;

(iv) either party's product plans, costs, prices and names; non-published financial information; marketing plans; business opportunities; personnel; research; development or know-how;

(v) any information designated by the disclosing party as confidential in writing, or, if disclosed orally, designated as confidential at the time of disclosure and deduced to writing and designated as confidential in writing within thirty (30 days; and

(vi) the terms and conditions of this Agreement; provided, however the "Confidential Information" will not include information that;

(a) is or becomes generally known or available by publication, commercial use or otherwise through no fault to the receiving party;

(b) is known and has been reduced to tangible form by the receiving party at the time of disclosure and is not subject to restriction;

(c) is independently developed by the receiving party without use of the disclosing party's Confidential Information;

(d) is lawfully obtained from a third party who has the right to make such disclosure or;

(e) is released for publication by the disclosing party in writing

1.4 "Design" means the representation of an electronic circuit or device(s), derived or created by License through the use of the Licensed Product in their various formats including, but not limited to, equations, truth tables, schematic diagrams, textual descriptions, hardware description languages and netlists.

1.5 "Design Techniques" means the Synopsys-supplied data circuit and logic elements, libraries, algorithms, search strategies, rule based and technical information incorporated in the Licensed Product and employed in the process of creating Designs.

1.7 "Documentation" means any user manuals, reference manuals, release, application and methodology notes, written utility programs and other materials in any form provided for use with the Licensed Product.

1.8 "End User(s)" means the authorized person(s) who access and use the client.

1.13 "Intellectual Property Rights" means all patents, patent rights, copyrights, (including copyright in computer software), design rights, database rights, semi-conductor topography rights, trade secrets service marks, maskworks and trademarks, whether or not registered or capable of registration, and any applications for any of the foregoing, in all countries in the world.

1.15 "License Key" means a document (in physical or electronic format) provided by Synopsys to Licensee which reflects the applicable Licensee purchase order and lists: (i) the Licensed Product, including version number and quantity, licensed to Licensee; (ii) the Key server(s); and (iii) the codes which Licensee must input to initialize use of the Key Server(s).

1.16 "Licensed Product(s)" means collectively Design Ware and the Licensed Software.

1.17 "Licensed Software" means' the Synopsys computer software program(s), exclusive of Design Ware, which are licensed by License in object code form and identified in the applicable License Key, including any Bug Fix Release and Minor Enhancement Releases provided by Synopsys pursuant to the terms of the Support Agreement and this Agreement and any Software Upgrade which may be licensed by Synopsys to Licensee.

1.18 "Minor Enhancement Release" means an embodiment of the Licensed Product that delivers minor improvement, incremental features or enhancements of existing features, and/or functionality to the Licensed Product.

1.19 "Software Upgrade" means an embodiment of the Licensed Product that delivers substantial performance improvements, architectural changes or new features and/or functionality to the "Licensed Product for which Synopsys may charge a separate license fee.

1.20 "Use Area" means the Key Server(s), Client(s) and End-User(s) all located within the same five (5) mile radius. Grant of rights

2.1 Software License Synopsys hereby giants Licensee a non-exclusive, non-transferable license, without right of sub-license, of use the Licensed Software and Design Techniques only: (i) in the quantity authorized by a License Key; (ii) in accordance with the Documentation; and (iii) in the Use area. Licensee may make a reasonable number of copies of the licensed Software for backup and/or archival purposes only.

2.1.1 <u>Term of License</u> The term of the license granted herein shall be continuous until non- renewal of the Support Agreement, (unless the license is sooner terminated in accordance with section 8 of this Agreement), whereupon Licensee shall be granted a twenty-(20) year key to use the Licensed Software at the last supported level, provided that if Licensee and Synopsys have agreed that Licensee may obtain time-based licenses for the Licensed Products, as indicated in the applicable quote, purchase order and/or License Key, the term of the license shall be as set forth in the applicable Licensee key.

2.2 <u>Design Ware License</u> If Licensee has purchased a license to Design Ware, Syncpsys hereby grants Licensee the following non-exclusive, non-transferable rights to Design Ware, with no right to sub-license (except as provided below):

(i) licensee may use Design Ware in the quantity authorized by the Design Ware License Key, in accordance with the Documentation, in the Use Area

(ii) licensee may Implementation IP into Licensee's Designs to create Integrated Designs;

(iii) licensee may make, have made, use and distribute products that are physical implementations of the Integrated Designs; and

(iv) if Licensee has purchased from Synopsys the right to use certain Implementation IP in support of Licensee's development of Integrated Designs.

Licensee may make a reasonable number of copies of Design Ware for backup and/or archival purposes only.

2.3 Documentation License Synopsys hereby grants Licensee a non-exclusive, non-transferable license, without right of sub-license, to use the Documentation and to make a reasonable number of copies of the Documentation solely for its own internal business purposes to support Licensee's use of the Licensed Product.

2.4 Evaluation License In the event Licensee obtains evaluation copies (which excludes any copy of the Licensed Products issued pursuant to Licensee's purchase order) of the Licensed Product the terms and conditions of this Agreement shall govern, except as follows:

(i) Licensee may use such Licensed Product only for internal, non-production evaluation for the purpose of deciding whether to purchase a license for such Licensed Product from Synopsys;

(ii) the tern of the Evaluation License will be as specified in the applicable License key; and

(iii) Section 9 is amended such that the Licensed Products is provided "AS IS"

2.7 Proprietary Notices. Licensee must reproduce and include the copyright notice and any other notices that appear on the original copy of the Licensed Product and Documentation on any copies may thereof by Licensee in any media.

2.8 License Restrictions. Licensee acknowledges that the scope of the licenses granted hereunder do not permit Licensee {and Licensee shall not allow any third party to:

(i) save as expressly permitted by and in accordance with the provisions of Regulation 6(2), 6 (3) and 7 of the EC (Legal Protection of Computer Programs) Regulations 1993, copy, adapt, decompile, disassemble, reverse engineer or attempt to reconstruct, identify or discover any source code, underlying ideas, underlying user interface techniques or algorithms of the Licensed product by any means whatever, or disclose any of the foregoing;

(ii) distribute, lease, lend, use for timesharing, service bureau, and/or application service provider purposes the Licensed Product;

(iii) use the Licensed Product for the benefit of third parties, or allow third parties to use the Licensed Product;

(iv) modify, incorporate into or with other software, or create a derivative work of any part of the Licensed Product;

(v) disclose the results of any benchmarking of the Licensed Product (whether or not obtained with Synopsys' assistance) to third parties;

(vi) use the Licensed Product to develop or enhance any product that competes with a Licensed product; or

(vii) employ the Licensed product in, or in the development of, life critical applications or in any other application where failure of the Licensed Product or any results from the use thereof can reasonably be expected to result in personal injury.

3. Ownership

3.1 Synopsys Ownership. Synopsys and/or its licensors own and shall retain all rights, title and interest in and to the Licensed Product, Design Techniques and Documentation, including all Intellectual Property Rights embodied therein, and Licensee shall have no rights with respect thereto other than the rights expressly set forth in this Agreement. Risk in the media only, passes upon Synopsys' delivery of the Licensed product to a common carrier, or for international shipments, delivery to the foreign port of entry. Title, in the media only, passes to the Licensee on payment of the license fees. Third party proprietary information may have been used in the development of certain Licensed Products, and any third party licensors of such products may enforce their rights under this section as third party beneficiaries. Such third parties are listed in the applicable Documentation.

3.2 Licensee Designs. Licensee shall retain all right, title and interest in and to Designs, Integrated Designs and all copies and portions thereof, subject to Synopsys' underlying rights in any Design Ware incorporated in such Designs and Integrated Designs.

5. Delivery Terms

5.1 Purchase Order. In order to obtain products and services from Synopsys, Licensee must first submit a purchase order. As part of a purchase order, Licensee must identify the Licensed product it wishes to License, the identity (by machine ID number) of the Key server(s) and the location of such Key Server(s). All purchase orders are subject to acceptance by Synopsys, in its sole discretion. Licensee's receipt and use of all Licensed Product and Documentation shall be governed by:

(i) the terms and conditions of this Agreements; and

(ii) any Agreement Supplement(s) which are executed by both parties. Nothing contained in any purchase order, purchase order acknowledgment, or invoice shall in any way modify such terms or add any additional terms or conditions; provided, however, that such standard variable terms as price, quantity, delivery data, shipping instructions and the like, as well as tax exempt status, if applicable shall be specified on each purchase order or acknowledgement Licensee's purchase order will include, the licensee fee and payment terms as set forth in the applicable Synopsys quotation. Licensee agrees to pay Synopsys the license fees, plus applicable taxes as set forth below, in accordance with the payment terms specified in the applicable Synopsys quotation and/or invoice.

5.3 Delivery. Upon the acceptance of an order by Synopsys and the satisfaction of all Synopsys prerequisites prior to delivery, Synopsys shall deliver to Licensee, at

Synopsys expense, the Licensed Product, License Key and/or Documentation, as appropriate.

6. Support Services

Support services shall be provided by Synopsys under the terms and conditions set forth herein and of the Support Agreement.

7. Confidentiality

Each party will protect the other's Confidential Information from unauthorised dissemination and use with the same degree of care that each such party uses to protect its own like information. Neither party will use the other's Confidential Information for purposes other than those necessary to directly further the purposes of this Agreement. Neither party will disclose to third parties the other's Confidential Information without the prior written consent of the other party.

8. Termination of License

8.1 Termination. Either party has the right to terminate this Agreement if the other party breaches or is in default of any obligation hereunder, which default is incapable of cure or which, being capable of cure, has not been cured with fifteen (15) business days after receipt of written notice from the non-defaulting party or within such additional cure period as the non- defaulting party may authorize, except that the Licensed Product's failure to substantially conform to the specifications in the Licensed Produce Documentation shall not be deemed a default under this section 8.1 but shall be subject to the exclusive remedies provided in section 9.1.

8.3 Effect of Termination. Upon termination, Licensee shall immediately cease all use of the Licensed Product (other than Design Ware incorporated into Designs prior to termination, for which Licensee's license shall continue according to its terms), Design Techniques and Documentation and return or destroy all such copies and all portions of the Licensed Product (other than Design Ware incorporated into Designs prior to termination) and so certify in writing in Synopsys Termination will not relieve Licensee or Synopsys from any liability Grising from any breach of this Agreement. Neither party will be liable to the other for damages of any sort solely as a result of terminating this Agreement in accordance with its terms, and termination of this Agreement will be without prejudice to any other right or remedy of either party. The provisions of sections 3, 7, 8.2, 8.3, 11, 12 and 13 shall survive any termination or expiration of this Agreement.

10. Patent and Copyright Infringement

10.1 Indemnity. Synopsys agrees, at its own expense, to defend or, at its option, to settle, any claim or action brought against Licensee to the extent it is based on a claim that the Licensed Software as sued within the scope of this Agreement infringes or violates any United States or European patent, copyright, trademark, trade secret or other proprietary light of a third party, and Synopsys will indemnify and hold Licensee harmless from and against any damages, costs and fees reasonably incurred (including reasonable attorneys' fees) that are attributable to such claim or action and which are assessed against Licensee in a final judgment. Licensee agrees that Synopsys shall be release from the foregoing obligation unless licensee provides Synopsys with:

(i) prompt written notification of the claim or action;

(ii) sole control and authority over the defense or settlement thereof; and

(iii) all available information, assistance and authority to settle and/or defend any such claim or action.

13.3 <u>Assignment</u>. This Agreement may not be assigned by Licensee without the prior written consent of Synopsys.

13.6 Independent Contractors. The relationship of Synopsys and licensee established by this Agreement is that of independent contractors, and nothing contained in this Agreement shall be construed (i) to give either party the power to direct or control the day-to-day activities of the other or (ii) to constitute the parties as partners, joint ventures, co-owners or otherwise as participants in a joint a common undertaking.

13.9. Injunctive relief. The parties agree that a material breach of this Agreement adversely entitled affecting Synopsys' Intellectual Property Rights in the Licensed Product, Design Techniques or Documentation would cause irreparable injury to Synopsys for which monetary damages would not be an adequate remedy and Synopsys shall be to equitable relief in addition to any remedies it may have hereunder or at law."

45. As is clear from the description of the agreement it is an end-user software licence agreement. Clause 2.1 deals with grant of rights. It provides, Software License Synopsys hereby grants licencee a non-exclusive, non-transferable license, without right of sub-licence of use the licensed software and design techniques only in the quantity authorized by a licensee in accordance with the documentation in the use area. Licensee may make a reasonable number of copies of the licensed software for backup and/or archival purposes only. Merely because the words non-exclusive and non-transferable is used in the said licence it does not take away the software out of the definition of the copyright. The word licenced software has been defined. Similarly, the words design, design technique is also defined. The word documentation is also defined and it is not in dispute what is granted is a license. Even if it is not transfer of exclusive right in the copyright, the right to use the confidential information embedded in the software in terms of the aforesaid licence makes it abundantly clear that there is transfer of certain rights which the owner of copyright possess in the said computer software/programme in respect of the copyright owned. In terms of the DTAA the consideration paid for the use or right to use the said confidential information in the form of computer programme software itself constitutes royalty and attracts tax. It is not necessary that there should be a transfer of exclusive right in the copyright as contended by the assessee. The consideration paid is for rights in respect of the copyright and for the user of the confidential information embedded in the software/computer programme. Therefore,

it falls within the mischief of Explanation (2) of clause (vi) of sub-section (1) of section 9 of the Act and there is a liability to pay the tax.

46. If there was any doubt regarding the taxability of this income the parliament by Finance Act, 2010 has substituted the explanation to section 9 which gives a clear intention of the legislature insofar as the liability of tax under this provision is concerned. A perusal of the said explanation makes it clear that as there was a doubt earlier, they want to remove the doubts by introducing this explanation. By the explanation they have declared that for the purpose of section 9 which deals with income deemed to accrue or arise in India, under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non- resident, whether or not (i) the non-resident has a residence or place of business or business connection in India, (ii) the non-resident has rendered services in India. Therefore, the object is to levy tax on the income of a non-resident, if it has accrued or arisen in India and one such income is the income from royalty

35. Expressing similar view, the Hon'ble High Court of Karnataka has held similarly in the case of Samsung(supra) as under: (para 20)

Having regard to the above said definition of "royalty", we have to con-sider the contents of software licence agreement entered into by the non-resident with Samsung Electronics and also the respondents in the case represented by Sri Ganesh, learned senior counsel and Sri Aravind Dattar, wherein it is a case of purchase, sale or distribution or otherwise of the off-the-shelf software. It is described as a "software licence agreement", wherein it is averred that customer accepts an individual, non-transferable and non-exclusive licence to use the licensed software program(s) on the terms and conditions enumerated in the agreement. It is further averred that the customer-Samsung Electronics-shall protect confidential infor-mation and shall not remove any copyright, confidentiality or other pro-prietary rights provided by the non-resident. However, what is granted under the said licence is only a licence to use the software for internal business without having any right for making any alteration or reverse engineering or creating sub-licences. What is transferred under the said licence is the licence to use the software and the copyright continue to be with the non-resident as per the agreement. Even as per the agreement entered into with the other distributors as also the end-user licence agree-ment, it is clear that the distributor would get exclusive non-transferable licence within the territory for which he is appointed and he has got right to distribute via resellers the software, upon payment of the licences set forth in exhibit A to the agreement only to end users pursuant to a valid Actuate shrinkwrap or other actuate licence agreement and except as expressly set forth in the said agreement, distributor may not rent, lease, loan, sell or otherwise distribute the software the documentation or any derivative works based upon the software or documentation in whole or in part. Distributor shall not reverse engineer, decompile, or otherwise attempt to derive or modify the source code for the software. The distri-butor shall have no rights to the software other than the rights expressly set

> forth in the agreement. The distributor shall not modify or copy any part of the software or documentation. The distributor may not use sub-distributors for further distribution of the software and documentation without the prior consent of Actuate. What is charged is the licence fee to be paid by the distributor of the software as enumerated in exhibit A to the agreement. Further, clause 6.01 of the agreement dealing with title states that the distributor acknowledges that actuate and its suppliers retain all right, title and interest in and to the original, and any copies (by whomever produced), of the software or documentation and ownership of all patent copyright, trade mark, trade secret and other intellectual pro-perty rights pertaining thereto, shall be and remain the sole property of Actuate. The distributor shall not be an owner of any copies of, or any interest in, the software, but rather is licenced pursuant to the agreement to use and distribute such copies. Actuate represents that it has the right to enter into the agreement and grant the licences provided therein and confidentiality is protected. Therefore, on reading the contents of the respective agreement entered into by the respondents with the non-resi-dent, it is clear that under the agreement, what is transferred is only a licence to use the copyright belonging to the non-resident subject to the terms and conditions of the agreement, as referred to above, and the non-resident supplier continues to be the owner of the copyright and all other intellectual property rights. It is well settled that copyright is a negative right. It is an umbrella of many rights and licence is granted for making use of the copyright in respect of shrink wrapped software/off-the-shelf software under the respective agreement, which authorizes the end user, i.e., the customer to make use of the copyright software contained in the said software, which is purchased off the shelf or imported as shrink wrapped software and the same would amount to transfer of part of the copyright and transfer of right to use the copyright for internal business as per the terms and conditions of the agreement. Therefore, the contention of the learned senior counsel appearing for the respondents that there is no transfer of copyright or any part thereof under the agreements entered into by the respondent with the non-resident supplier of software cannot be accepted.

36. The principles laid down by the two judgements of the Hon'ble Karnataka High Court are applicable to the present cases as the fact of supply of software is similar.

37. In the case of Lucent Technologies (270 ITR(AT) 62(Bang), the ITAT has held that what the assessee supplied was a copyrighted article which does not involve any royalty. That order of the ITAT was not upheld by the Hon'ble Karnataka High Court. Subsequently when the matter was restored by the Hon'ble Supreme Court, the Hon'ble Karnataka High Court in assessee's group case itself, Lucent technologies 348 ITR 196(Kar) held that supply of software is to be considered as royalty.

It was held:

> *The assessee imported software from the USA for the assessment years 1999-2000 to 2002-03. It had also separately imported hardware from Taiwan. The Income-tax Officer initiated proceedings*

under section 201(1) and 201(1A) of the Income-tax Act, 1961, against the assessee for failure to deduct tax at source in respect of payment made for the software imported from the USA. The case of the assessee was that it had obtained orders from the Department of Telecommunications for manufacture and supply of telecommunications/switching equipment. In order to execute its orders in India it had placed separate orders for software and hardware and integrated them and had executed its commitment to the Telecommunications Department. The Income-tax Officer and as confirmed by the Commissioner (Appeals) proceeded to hold that the software and the hardware had been imported by the assessee, through two separate countries and integrated in India by the assessee. The execution of the contract by the assessee with the Telecommunications Department in India was a separate contract from the import of software from the USA. It was held that the payments were made for supply of software which was utilised by the assessee and, consequently, the provisions of section 9(1)(vi) of the Act read with the Double Taxation Avoidance Agreement between India and the USA were applicable. The Tribunal held that the payment made by the assessee for acquiring the software could not be termed royalty payments and, therefore, no deduction of tax was necessary and, consequently, section 195 was not applicable. On appeal to the High Court :

Held,

allowing the appeals, that the supply of software from the USA to the assessee was an independent transaction. The hardware utilised by the assessee was received from Taiwan. Only after receipt of both the software and the hardware, had they been integrated by the assessee in India and thereafter supplied to the Department of Telecommunications as an end product in terms of the assessee's independent contract. Therefore, the finding recorded by the Tribunal was erroneous. Consequently, the payments made by the assessee amounted to royalty and were liable to be taxed in India under section 9(1)(vi) read with the Double Taxation Avoidance Agreement.
Order of the Appellate Tribunal in Lucent Technologies Hindustan Ltd. v. ITO [2004] 270 ITR (AT) 62 (Bang) set aside.

38. In the light of the above principles laid down by the Hon'ble Karnataka High Court, that too in group case itself on same terms of agreement as that of with Reliance for supply of software, we are inclined to follow the judgements of the Hon'ble Karnataka High Court over the decision of the Special Bench of the ITAT in the case of Motorola (supra) which was rendered in a different fact situation.

39. In the cases before us, the learned counsel for Lucent fairly admitted that the issue is to be decided in the light of the judgement of the Hon'ble Delhi High Court vis-à-vis the judgement of the Hon'ble Karnataka High Court. As stated earlier the facts in the case before the Hon'ble Delhi High Court was for supply of software alongwith hardware as embedded software as a part of one agreement and its installation for which no separate payment was made, whereas in this case Reliance purchased the software by virtue of stand-alone agreement(s) named as 'software license agreement(s)'.

40. In all the DTAA with the countries Reliance purchased software, the terms of DTAA are similar, though restricted in meaning when compared to definition of Royalty under the Income Tax Act 1961.

1. USA: Article 12(3)

The term "royalties" as used in this article means:

a. payments of any kind received as consideration **for the use of, or the right to use**, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof; 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 payments derived by an enterprise described in paragraph 1 of article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of article 8.

2. Israel: Article 12(3)

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

3. China: Article 12(3)

The term "royalties" as used in this Article means payment 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 and films or tapes for radio or television broadcasting, any patent, trade mark design or model, plan, secret formula or process or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

4. Sweden: Article 12(3)(a)

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.

5. Singapore: Article 12(3)

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

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

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

6. Japan: Article 12(3)

The term "royalties" as used in this article means payments of any kind received as a consideration **for the use of, or the right to use**, any copyright of literary, artistic or scientific work including cinematograph films and films or tapes for radio or television broadcasting, any patent, trade-mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

7. Australia: Article 12(3

The term "royalties" in this article means payments or credits, whether periodical or not, and, however described or computed, to the extent to which they are made as consideration for:

a. **the use of, or the right to use**, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;

b. **the use of, or the right to use**, any industrial, commercial or scientific equipment;

c. the supply of scientific, technical, industrial or commercial knowledge or information;

d. the rendering of any technical or consultancy services (including those of technical or other personnel) which are ancillary and subsidiary to the application or enjoyment of any such property or right as is mentioned in sub-paragraph (a), any such equipment as is mentioned in sub-paragraph (b) or any such knowledge or information as is mentioned in sub-paragraph (c);

e. the use of, or the right to use:

i. motion picture films;

ii. films or video tapes for use in connection with television; or

iii. tapes for use in connection with radio broadcasting;

f. total or partial forbearance in respect of the use or supply of any property or right referred to in sub-paragraphs (a) to (e); or

g. the rendering of any services (including those of technical or other personnel) which make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or design; but that term does not include payments or credits relating to services mentioned in sub-paragraphs (d) and (g) that are made;

h. for services that are ancillary and subsidiary, and inextricably and essentially linked, to a sale of property;

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

j. received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematographic films or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft, or for information concerning industrial, commercial or scientific experience;

9. Canada: Chapter III Article 12(3)

The term "royalties' as used in this Article means:

a. payment 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 film 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 process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; 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 payments derived by an enterprise described in paragraph 1 of Article 8 from activities described in paragraph 3(c) or 4 of Article 8.

10. United Kingdom of Britain and Northern Ireland: Article 13(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 or reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; 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.

11. Netherlands: Chapter III Article 12(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 cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

The words used are similar and the same was considered by honble Karnataka High court in the case of Synopsis(supra) as under.

39. It is no doubt true the provisions of the DTAA overrides the provisions of the Income-tax Act. In the DTAA the term 'royalty' means payments of any kind received as a consideration for the use or the right to use any copyright of literary, artistic or scientific work whereas in the Income-tax Act, royalty means consideration for the transfer of all or any rights including the granting of a licence. Therefore, under the DTAA to constitute royalty there need not be any transfer of or any rights in respect of any copyright. It is sufficient if consideration is received for use of or the right to use any copyright. Therefore, if the definition of royalty in the DTAA is taken into consideration it is not necessary there should be a transfer of any exclusive right. A mere right to use or the use of a copyright falls within the mischief of Explanation (2) to clause (v) of sub-section (1) of section 9 and is liable to tax. Therefore, we do not see any substance in the said contention.

Further the Ho'ble High Court in the case of Samsung electronics also considered similarly as under:

In view of the abovesaid observations and the contents of the DTAA with different countries, wherein the definition of "royalty" is common in all the agreements, it is necessary to reproduce the said definition of 'royalty' in article 12 of the DTAA, which reads as under :

"Article 12 of DTAA with the USA (see [1991] 187 ITR (St.) 102, 115) :

12. Royalties and fees for included services-

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

(3) The term 'royalties', as used in this article, means :

(a) payments of any kind received as consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model plan, secret formula or process, or for information concerning industrial, commercial or scientific expe-rience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof ; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equip-ment, other than payments derived by an enterprise described in paragraph (1) of article 8 (Shipping and Air Transport) from activities described in paragraph (2)(c) or (3) of article 8."

In view of the abovesaid definition of "royalty", it is clear that the necessary ingredient to be satisfied to find out as to whether the payment would amount to "royalty" is as follows-

-payment of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work.

It has been universally accepted that a literary work is entitled to copyright and wherefore, a literary work is entitled to be registered as copyright. In India, the provisions of section 2(o) of the Copyright Act, 1957, defines "lite-rary work" as under :

"'literary work' includes computer programmes, tables and compi-lations including computer databases

Therefore, "computer software" has been recognized as copyright work in India also.

41. Further, In the case of Citrix Systems Asia Pacific Pte Ltd 343 ITR 001, The AAR on similar facts considered and held:-

When a software is created by a person who acquires a copyright for it, he becomes the owner of that copyright. He can transfer or license that right either by himself or through an agent. When he sells or licenses the software for use, he also sells or licenses the right to use the copyright embedded therein. If a software is used without being lawfully acquired either by purchase or by license, that would amount to an infringement of the copyright because of the copyright embedded in the software. The software is a literary work and the copyright of the creator over the software is an important and commercially valuable right. So, whenever a software is assigned or licensed for use, there is involved an assignment of the right to use the embedded copyright in the software or a license to use the embedded copyright, the intellectual property right in the software. It is not possible to divorce the software from the intellectual property right of the creator of the software embedded therein. Even the right to sell or give on rental, would amount to a copyright and would be a right to be dealt with as a copyright.

The definition of "royalty" in the Income-tax Act, 1961 is, consideration for the transfer of all or any rights (including the granting of a license) in respect of a patent, innovation, model, *design, secret formula or process or trade mark or similar property. Consideration for grant of the use of any of the above is also royalty. It also takes in the consideration for the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work. License is not confined to an exclusive license. When a software, over which a copyright is acquired and thus owned, is licensed for use to another or sold to another for his own use, the licensee or the purchaser gets the right to use the software without being held guilty of infringement of the copyright. When the use of software, without anything more, would render the user liable for infringement of the copyright embedded in the software, the sale or the licensing of the software involves the grant of a right to use the copyright in the software and right to use the intellectual property embedded in the software. Therefore, the licensing of a software for use by the end-use customer, is not the mere sale of a copyrighted article.*

The words within brackets, "including the granting of a license" indicate an expansive definition. The word "includes" is an inclusive definition and expands the meaning. Therefore, license cannot be restricted to transfer of a right dealt with earlier by the provision and should be understood as taking in the grant of a license simpliciter.
Article 12 of the Double Taxation Avoidance Agreement between India and Australia (DTAA) defines "royalties" to mean "payment made as consideration for the use of or the right to use any copyright, patent, design or model, plan, secret formula or process, trade mark or other like property or right". When the DTAA speaks of royalty, and defines it, it must be understood as it is commonly understood. The article speaks of the use of or the right to use any copyright. Use of a copyright takes place when the copyright is used. This is distinct from the right to use a copyright. The two expressions are used disjunctively and the expression used is "or". The context does not warrant the reading of "or" as "and". If so, the consideration received for permitting another to use a copyright is also royalty.

A copyrighted article is nothing but an article which incorporates the copyright of the owner, the assignee, the exclusive licensee or the licensee. So, when a copyrighted article is permitted or licensed to be used for a fee, the permission involves not only the physical or electronic manifestation of a programme, but also the use of or the right to use the copyright embedded therein.

That apart, article 12(3) of the DTAA defines royalties as payments, whether periodical or not and, however, described or computed, as consideration for "the use of, or the right to use any copyright, patent, design or model, plan, secret formula or process, trade mark or other like property or right". The definition is wider than that contained in the Act. It also ropes in payment of consideration for the use of a copyright in addition to the consideration paid for the right *to use a copyright, covered by the definition in the Act. Consideration paid for use of a copyrighted software is also payment for use of the copyright embedded in the software. There cannot be a use of software, over which exists a copyright, without a use of the copyright therein. The payment for such use can only be royalty.*

The sale or licensing for use of a copyrighted software amounts to the grant of a right to use a copyright.

P. No. 30 of 1999, In re [1999] 238 ITR 296 (AAR) relied on a ruling by the Authority is based on the facts involved in the application leading to that ruling. The doctrine of precedent cannot be applied to a ruling under section 245R(4) of the Act. The Act has itself made it clear that the ruling is binding on the applicant in the application and the Revenue, in respect of that application and the transaction involved therein.

The applicant, a company incorporated in Australia and provider of software services, entered into agreements with Indian distributors for the distribution and sale of its software and hardware products in India. In the year 2006, the applicant entered into a distribution agreement with I, an Indian company engaged in the business of distribution of computer software and hardware, under which I was appointed non-exclusive distributor of the pro-ducts of the applicant in India. For the software product, Citrix XenApp, while sale and collection was made through the distributor, no physical delivery of the product was made to the distributor. On the basis of the demand of the customers, the distributor placed orders of purchase with the applicant and made payments to the applicant. The applicant then directly transmitted a "key" to the end-user customer who, on receipt of the key, downloaded the software from the server of the applicant. In addition, I also facilitated the execution of the Citrix subscription advantage programme between the applicant and its existing customers. The programme was a package of support services during the period of the programme, including product version updates, subscription advantage news and updates and secure portal access. The applicant sought an advance ruling on the taxability in India of payments made by I to it for the software product, Citrix XenApp and the subscription advantage programme. The questions framed by the Authority were whether the payments received by the applicant from the distributor for sale of the software product were in the nature of "royalty" within the meaning of the term in Explanation 2 to clause (vi) of section 9(1) of the Income-tax Act, 1961, or within the meaning of the term in article 12 of the Double Taxation Avoidance Agreement between India and Australia, whether the payments received by the applicant from the distributor for the right to download/receive version updates for the software products of the- applicant were in the nature of "royalty" within the meaning of the term in Explanation 2 to clause (vi) of section 9(1) of *the Act, whether the payments received by the applicant from the distributor for the Citrix subscription advantage programme were in the nature of "fees for technical services" within the meaning of the term in Explanation 2 to clause (vii) of section 9(1) of the Act, whether the payment received by the applicant from the distributor for the Citrix subscription advantage programme, was in the nature of "royalty" within the meaning of the term in article 12 of the DTAA and in the light of the declaration provided by the applicant that it did not have a permanent establishment in India in terms of article 5 of the DTAA, whether the payment received by the applicant was chargeable to tax in India and would the receipts by the applicant from the distributor suffer withholding tax under section 195 of the Income-tax Act, 1961, and at what rate.*

The Authority on the stated facts, ruled :

(i) That the payments received by the applicant from the distributor for sales of the software products were in the nature of royalty within the meaning of section 9(1)(vi) of the Income-tax Act, 1961.

(ii) That the payments concerned would be royalty as defined in article 12 of the DTAA between India and Australia.

(iii) That the payment received by way of subscription for the updates would also be payment received for grant of a right to use the copyright embedded in the subscription advantage programme and it will be royalty.

(iv) That it was not necessary to rule on the question whether the payment for subscription advantage programme would be in the nature of fees for technical services within the meaning of the Income-tax Act.

(v) That the payment received by the applicant from the distributor for the Citrix subscription advantage programme was royalty within the meaning of clause (a) of article 12(3) of the DTAA between India and Australia. It was not necessary to consider the question whether it would fall under clause (g) of article 12(3) of the DTAA.

(vi) Even accepting that the applicant did not have a permanent establishment in India, the amount was liable to be taxed in India under article 12(2) of the DTAA.

(vii) That the distributor I was required to withhold taxes in India at the time of making payments to the applicant in terms of section 195 of the Income-tax Act at the rate of 10 per cent. of the gross amount of royalty, as provided under article 12(2) of the DTAA.

42. In the case of Microsoft Corporation vs. ADTT/Gracemac Corporation 42 SOT 550, ITAT Delhi Bench has held that payment made for grant of license in respect of copyright by end user is taxable as Royalty as per section 9(i)(vi).

43. In the case of Millennium Software Ltd. 338 ITR 391, it was held by AAR that the consideration received by the applicant, a similar company, from ICEL for giving it the right to use its copyright software and use it for latter's own purposes whenever and whatever needed by it is in India as Royalty under clause V of Explanation 2 of section 9(i(vi) as well as under section 12.2 of India – Sri Lanka DTAA and consequently, provision of withholding tax under section 195 is applicable.

44. In the case of Labs India P. Ltd. 287 ITR 450 (AAR) has held that Article 12 defines Royalty to mean payments of any kind received as consideration for the use of or right to use any industrial, commercial scientific equipment, the software application of non-resident is ruled to be scientific equipment, licensed to be used for commercial purpose. Therefore payment is in the nature of Royalty and were subject to TDS.

45. In the case of CIT vs. Wipro Ltd. 203 Taxman 621 (Kar) it was held that 'G; had maintained a database and it had granted online access of the same to the assessee, therefore, the payment made by the assessee for license to use the database maintained by G was to be treated as Royalty.

46. It is clear that under various agreements, what is transferred is only a licence to use the copyright belonging to the non-resident, subject to the terms and conditions of the agreement, as referred to above, and the non-resident supplier continues to be the owner of the copyright and all other intellectual property rights. It is well settled that copyright is a negative right. It is an umbrella of many rights and licence is granted for making use of the copyright in respect of shrink wrapped software/off-the-shelf software under the respective agreement, which authorizes the end user, i.e., the

customer to make use of the copyright software contained in the said software, which is purchased off the shelf or imported as shrink wrapped software. The same would amount to transfer of part of the copyright and transfer of right to use the copyright for internal business as per the terms and conditions of the agreement. Therefore, the contention that there is no transfer of copyright or any part thereof under the agreements entered into by the Reliance with the non-resident supplier of software cannot be accepted. Under these circumstances, payment made by the Reliance to LTGL/ other suppliers can be said to be payment for the use of or right to use of copyright and does amount to royalty within the meaning of Artilce-12(3) of the DTAA. It is accordingly held that the AO was justified in directing to deduct the tax at source u/s.195.

47. As can be seen from the paper books filed in this regard, many of the software license agreements are common and more or less similarly worded, and involves purchase of software by way of granting license. The agreement in the case of M/s Lucent was already extracted by the authorities and we are of the opinion that we need not discuss the same. In fact the Reliance also admitted that there were only supply of software, without purchase of equipments either from the same party or from any other party. There are certain agreements which are only 'License agreements' and are not seller or vendor agreements as in other cases. The exclusive License agreements are in the following cases.

1. Clarity International Ltd, Australia (PB 654-682) vide agreement dt 29/03/05 assigned to Reliance Communications by Reliance Industries. (ITA nos. 5089/M/08).
2. Comverse Ltd, Israel vide agreement dt26/08/02 (PB 831-866). Amount paid was termed as License fee and License to copy was also granted. (ITA no. 5470/M/08, 4280/M/08, 4250/ M/ 08, 4253/M/08, 4254/M/08, 4308/M/08,4673/M/08).

3. Legato systems Netherland BV, Netherlands4253/M/08 vide agreement dt.24/02/03 (PB 742-762) (ITANos 5471/M/08, 4281/M/08, 4902/M/08).

4. 3 Com Asia Pacific RIM Pte Ltd, vide agreement dt.07/01/03 (PB 1545-1617) where in it was stated that what is sold and Reliance purchased is Software license. The agreement is for purchase of License only. (ITA No 4875/M/07).

5. Enea Embedded Technology AB, Sweden(PB 290-315) vide agreement dt 01/12/05 for software license and amount paid is classified as License fee. (ITA No 5083/M/08).

6. Selectia Inc, USA vide agreement (PB 732-741) dt 02/06/05 for software license and amount paid is classified as License fee and maintenance fee is also specified. (ITA No 5092/M/08).

7. Open Wave systems Inc, USA (PB 790-830) vide agreement dt 18/06/05 for software license and amount paid is classified as License fee. In addition to licencing of software Logo and Trade marks of Wave were also specified (ITA No 5475/M/08).

8. Ulticom Inc, USA (PB 1113-1154) vide agreement dt 07/09/03 for software licenses and associated services (ITA Nos 4283/M/08, 4244/M/08, 4247/M/08, 4306/M/08, 4877/M/07, 4905/M/07, 4910/M/07).

9. Motorola Inc, USA (PB 1113-1154) vide various purchase orders with annexure specifying software License. (ITA Nos 4878/M/07, 4904/M/07, 4247/M/08, 4306/M/08, 4877/M/07, 4908/M/07, 4675/M/07).

10. Mantra Communications Inc, USA (PB 784-793) vide purchase orders dt. 30/11/01 specifying software License for source code license also. (ITA Nos 729/M/09).

11. Green Hills Software Inc, USA (PB 1660-1667) vide agreement dt. 14/12/05 specifying software License and management agreement. (ITA Nos 5072/M/08).

12. Venturi Wireless Inc, USA (PB 241-289) vide agreement dt. 23/11/05 specifying License and Annual maintenance agreement. (ITA Nos 5082/M/08, 5075/M/08).

48. The agreement with M/s Neura Communications Inc USA (PB 214-240) vide agreement dt. 19/10/2005 is termed as Purchase and Reselling agreement, terms of which are different (ITA Nos. 5081/M/08). Similarly agreement with New Skies Satellites NV, Netherlands is for hiring transponder which will be dealt with later separately (ITA Nos 5374/m/08, 6093/M/08).

49. Therefore, we hold that Ld. CIT(A) erred in treating that there is no necessity to deduct Tax holding. We are conscious of the fact that the appeals are in the context of deduction under section 195. As held by the Hon'ble Supreme Court in the case of Transmission Corporation of AP Ltd. vs CIT 239 ITR 587 (SC), the tax has to be deducted at source on sum chargeable under the Act in the case of non-residents under section 195(1). Section 195 repose a statutory obligation on any person responsible for paying to non-resident any interest (not being interest of securities) or any other sum (not being dividend) chargeable under the provisions of the Act to deduct income tax at the rate in force unless he is liable to pay income tax thereon as an agent. The assessee did deduct the tax as per the directions of the AO under section 195(2). Since we have come to the conclusion that the amount paid by Reliance is to be treated as Royalty chargeable under the Act of the Income Tax, the order of the AO to that extent are upheld. We have also kept in mind the decision of the Hon'ble Supreme Court in the case of Agagrwal Chamber of Commerce Ltd. vs. Ganapat Rai Hira Lal 33 ITR 245 (SC) wherein it was held that persons who are bound under section 195 to make deduction of income tax at the time of making payments of any income, profits of gains are not concerned with the ultimate results of the assessment of the non-resident persons from whose income they deducted and paid income tax in India. In case of any of the recipients are aggrieved, they can file a return and claim the amount as not taxable as was the case

in the appeal of Motorola, Nokia and Erickson (Supra) wherein those assessees contested that the amounts they received are not taxable. As seen from the appeal of M/s Lucent also, they have chosen not to file returns and take credit for the tax deducted at source initially. Only in the proceedings under section 147, the issue about taxability has been raised in the appeals. Otherwise like many of the other recipients, they would not have contested the taxability of income. As we have held that these amounts are taxable as Royalty, to that extent we uphold that the direction of the AO to deduct tax under section 195.

50. Consequently, In all the Revenue appeals against Reliance, (except ITA No.5374 and ITA No.6093 which are separately dealt later) orders of the CIT(A) are set aside and orders of the AO are restored.

ITA Nos.7001 to 7004/ M/10. Lucent Technologies GRL LLC

51. These appeals pertain to Lucent Technologies, GRL LLC. As briefly stated above, the issue in these appeals is with reference to the taxability of the amounts received from supply of software to Reliance. The AO held the same as royalty in nature and in the alternate, also considered that there is a PE in India and so the business profits are attributable to the PE. Along with the above two issues there are issues on non-granting of TDS credited, levy of interest also.

52. The issue of royalty was considered above in detail and consequent to the findings therein, it is considered that amounts paid by Reliance for supply of software under a licence agreement is to be considered as royalty under the provisions of the Act and also under DTAA and liable to tax in India. Accordingly, the grounds raised by Lucent from Ground No.2 to 5 are rejected.

53. The next issue to be considered is attribution of business profit to the PE. Vide para 4.18 of the order of the AO for the impugned year,, the AO gave a finding that payment made for software would be termed as royalty payments and necessary tax rates have been mentioned in the table.

Further, considering the agreements entered by Reliance with Lucent Group the AO was of the opinion that there existed an Agency PE. Vide para 5.8 of the order the AO also considered that in case it is held that assessee's income is not taxable as royalty, the assessee's business profits have to be worked out in view of it having a PE in India. We have already held that payments made by Reliance have to be considered as royalty and accordingly the same are to be taxable as royalty only. Therefore, there is no need to consider the same as business profits. However, the issue of PE has to be decided, as existence of PE makes business profit taxable in India. Therefore, it is necessary to give a finding on the existence of PE to the assessee Lucent.

54. The AO invoking provisions of Article-5 of DTAA, was of the opinion that an agency PE is coming into picture as substantive functions of negotiations, entering into contract, stocking of goods or merchandising is being done by India enterprise i.e., LTHPL. He referred to various terms of agreement entered between the parties particularly the Assignment and Assumption Agreement, including the scope of services for maintenance of software entered by LTHPL. The AO was of the opinion that in this case, not only original agreement has been entered into by the Indian Company but services relating to making software operation or warranties or maintenance were also being done by LTHPL only. In addition to that terms of the agreements , the AO also relied on documents found in the course of survey in the premises of Alcatel Lucent International Ltd. (got merged entity of LTHPL) more particularly with respect to letter of agreement dated 06.09.2008 between group concerns with Reliance Communications regarding restructure of payment mile stone. The AO ultimately concluded that there existed an agency PE and accordingly, since assessee has a PE in India, the business profits are taxable and worked out profits at 32% of the total receipts.

55. It was the submission of the assessee that LTHPL was acting independently and assessee has no agency agreement or no business

connection in India except supply of software. It was also further submitted that no service personnel came to India so as to come under Service PE. The ld. Counsel for the assessee also relied on Article-5 of the DTAA and decision of co-ordinate Bench in the case of *Western Union Financial Services Inc. vs. ADIT (104 ITD 34)(Del.)* to submit that mere use of software for the purpose of business in India need not lead to an agency PE as assessee was not rendering any service in India nor LTHPL is authorized to deal with outsiders on behalf of assessee Lucent. Further, it was submitted that the co-ordinate Bench in the case of *Lucent Technologies International Inc. vs. DCIT, Non-resident Circle (28 SOT 98)* considered the facts in the case to hold that there is a service PE in that case. It was submitted that mere existence of a PE to a group company does not lead to a finding that the assessee also as a PE in India. It was further submitted that AO's reliance on a document i.e., subsequent restructured agreement for payment by the group companies does not indicate that any one of them is authorized to enter into contract on behalf of the assessee Lucent and further, agreement was dated 06.09.2008 does not pertain to any of the impugned assessment years. Nothing was brought on record by the Revenue that there is a PE except relying on the so called agreement which was entered on a principle to principle basis.

56. The ld. Counsel however relied on the orders that the AO as supported by DRP. It was further submitted that assessee chose not to file return after TDS was made and therefore, since proceedings are initiated under section 148 assessee can not seek any benefit in the proceedings initiated for the benefit of the revenue . He relied on the judgment of Hon'ble Bombay High Court in the case of *K. Sudhakar S. Shanbhag Vs ITO (241 ITR 865)* for the proposition of "doctrine of election".

57. We have considered the rival submissions. In the case of *Lucent Technologies International Inc. (28 SOT 98)* the co-ordinate Bench at Delhi considered the facts and held as under :-

> *The agreement entered into between the assessee-company and the Indian Company, Escotel, as also the agreement entered into between*

Escotel and the Indian subsidiary, LTIL showed that the agreements were for two different purposes. The agreement between Escotel and the assessee was for the supply of the hardware and software; the agreement between Escotel and LTIL was for commissioning, installation and operations. However, both the agreements provided for the turnkey functioning of the project of the GSM network. Therefore, by entering into the contract with both, the assessee and LTIL, Escotel had made both the assessee and LTIL responsible for the turnkey completion of the GSM project, individually and severely. Thus, if either one would break its terms and conditions of the agreement with Escotes, the other would be responsible for its completion. Thus, consortium or partnership had been created between the assessee and its Indian subsidiary, LTIL. With that situation, the next question for consideration arose as to whether either the assessee or its subsidiary, LTIL could complete the contract with Escotel on a turnkey basis without the assistance of the other. Obviously, the assessee was to supply the hardware and the software and LTIL was to do the installation, testing, commissioning and bringing up to operational stage the turnkey project. If the assessee did not provide the hardware and the software, it would be the duty of LTIL to provide the requisite hardware and the software for the completion of the turnkey project. Similarly, if LTIL did not comply with its duties of commissioning, installation, testing and bringing up to operational stage the turnkey project, such responsibility would rest on the shoulders of the assess. There was no dispute in that the assessee had completed part of its contract, i.e., the supply of the hardware and the software. The installation, commissioning, testing and bringing up to operational state of the hardware and the software supplied by the assessee had been undertaken by the Indian Subsidiary, LTIL. For said purpose, LTIL had also taken the assistance of the employees of the affiliates of the assessee. Thus, the parent company, being the assessee had made personnel available to the LTIL, the subsidiary in form of the employees of the affiliates of the assessee at certain remuneration. Further, a perusal of the agreement between Escotel and the assessee clearly showed that the warranty provided by the assessee-company was in relation to the defects in the hardware. That warranty clause in identical form was also found in the agreement entered into between Escotel and LTIL. Normally, the warranty for a particular product to be supplied by one person is the responsibility of that person alone, but in the instant case, that burden was also shifted to the subsidiary, being LTIL. Though LTIL had certified that it did not keep any spares on behalf of the assessee for the equipments supplied by the assessee under the contract with Escotel, yet the fact that LTIL had also assumed the responsibilities of the warranty in regard to the hardware supplied by the assess, as also the responsibility to replace the same within the period specified in the support contract between Escotel and LTIL clearly showed that the subsidiary, LTIL was also acting on behalf of the assessee. A perusal of article 5(2)(1) of the DTAA between India and the USA clearly shows that it is not only the employees through whom if services are provided, the PE is to said to come into existence, it also includes other personnel. Obviously, the term *'other personnel' has to be read with reference to the earlier words, as provided in the said article 5(2)(1). The other personnel specified would be the persons over whom the enterprise would be having a control. In the instant case, undisputedly, employees of the affiliates of the assessee had been employed through LTIL for providing the services of installation, commissioning, testing and bringing up to operational stage of the hardware and the software sold by the assessee to Escotel through its contract in regard to GSM project which was to be completed on a turnkey basis. Those employees of the affiliates over whom the assessee had a control would fall within the term 'other personnel' and, consequently, it would have to be held that a PE did exist as per the inclusive term as provided in article 5(2)(1) of the DTAA. A copy of the returns of the aforesaid employees also clearly showed that they had been staying in India for more than 90 days within the 12 month period from April, 1996 to March, 1997. Consequently, the requirements of article 5(2)(1) of the DTAA were fulfilled. In such circumstances, it was to be held that LTIL, in fact, was a service PE of the assessee-company. As a result, the findings of the Commissioner (Appeals) on the aforesaid issues were to be set aside."*

58. However, the facts in the present case are different for the above case. Here LTHPL entered into an agreement for supply of hardware, software and also installation and that company is an Indian company. After entering into an agreement supply of software was assigned to the assessee Lucent by way of the Tripartite agreement between Reliance and LTHPL and assessee Lucent. Eventhough, installation was on Indian company there is no evidence of either deputing personnel of assessee Lucent to India nor there is any evidence in the record for invoking Service PE as in other case. Moreover for invoking Agency PE , facts do not support AO's contentions. The agreement entered is an independent agreement, entered on principle to principle basis and nowhere the Indian company has authorized or has undertaken any responsibility of the assessee Lucent. On the facts of the case we are of the opinion that there do not exist any PE, more so of agency PE. It is also not the case of the Revenue that the assessee deputed its personnel to India so as to invoke Service PE as per Indo-US DTAA. In view of the above, we hold that there is no PE to the assessee company in India and as there is neither any office in India nor it has any business connection in India nor carried out any business activities in India. Assessee's company is a standalone legal independent entity. Therefore,

assessee's ground nos. 6 to 12 are upheld, as there is no PE in India, so attribution of profits does not arise.

59. Non granting of TDS credit:- AO did not give credit to the TDS claimed by assessee. At the outset it was submitted that this issue is covered by the decision of co-ordinate Bench of the Tribunal in assessee's own case in *45 SOT 311 Lucent technologies GRL LLC vs. DR. director IT (Intl. taxation) Circle-4(1(, Mumbai* wherein it was held :-

> *"The assessee-company with fiscal domicile in U.S.A. was engaged in business of supply of copyrighted software in connection with telecommunication project. The assessee received certain amount From 'R' Ltd., towards supply of software out of which tax was deducted at source by 'R' Ltd. It also issued TDS certificates to the assessee. On the basis of said TDS certificates the assessee claimed, credit for tax deducted at source. In the meantime, 'R' Ltd. claimed that no taxes were deductible from payment made for supply of copyrighted software and, accordingly, application to Assessing Officer requesting permission to make remittance to assessee without any deduction of tax at source but same was rejected by the Assessing Officer. Subsequently, 'R' Ltd. was refunded the amount which it had deducted at source from the payment made to the assessee. Therefore, assessee's claim of credit for TDS was declined by the Assessing Officer on ground that 'R' company had been refunded the amount of TDS, hence, certificate issued by 'R' Ltd. no longer remained valid. On appeal, the Commissioner (Appeals) upheld said order.*
> *0n second appeal:*
> *HELD*
>
> *The short question that was required to be answered in the instant case was as to whether lawful implications of a valid tax deduction certificate can be declined on the ground that the person who has issued tax deduction certificates has been refunded the taxes which he had deposited with the Government. [Para 6]*
>
> *There was no dispute that the taxes had been deducted in accordance with the provisions of section 195, the tax deductor had fulfilled his obligations under section 200and that tax deduction certificates had been issued under section 203 - At least to the extent of tax deductions. All these requirements had been duly complied with, and, in all fairness to the Assessing Officer, the compliance in respect of these provisions had not even been questioned. The only reason that had prompted the Assessing Officer to decline the credit in respect of the TDS certificates was that 'R' Ltd. had been refunded taxes which were deducted by 'R' Ltd. and which were deposited with the Government of India. [Para 7]*

It was also an undisputed position that such a refund to tax deductor, as had been granted in the instant case, was not prescribed under the scheme of the Act but appeared to be an administrative exercise. Department could not point out any provisions of law under which such a refund could be made particularly as TDS certificates were already issued by the tax deductor, and no fault was found in the certificates so issued. [Para 8]

The rights were granted to the person, from whose income taxes were so deducted and who is issued the tax deduction certificate in the prescribed manner, by the statute and those rights could not be abridged by an administrative action on the part of the revenue authorities and particularly when the person, whose rights were being sought to be abridged, was not even a party to the administrative exercise or was known of refund being granted to 'R' 'Ltd. Refund granted to 'R' Ltd. By revenue authorities could not have adverse impact on the rights of the assessee. That was a matter between the tax authorities and 'R' Ltd., one was sure that the revenue authorities, while granting the refund, must have safeguarded their interests effectively, and perhaps by now 'R' Ltd. might have even returned the monies, but assessee could not be expected to get into these aspects of the matter. in the instant appeal, one was confined to the issue that the assessee, from whose payments taxes had been deducted at source and who was also in receipt of the appropriate certificates in accordance with the scheme of the Act, must get credit admissible under section 199 and that such a credit was not declined on the basis of an action which was neirher contemplated by the provisions of the Act, nor even in the control of the assessee. [Para 9]

In view of the above discussions, the Assessing Officer was directed to grant due credit to the assessee, on the basis of original tax deduction at source certificates produced by the assessee, in accordance with the law and as long as taxes so deducted had been paid over to the Government and certificates in respect of the same had been issued by the tax deductor uninfluenced by any refunds subsequently granted to the tax deductor. The refund made to the tax deductor, even if wrongful, had no adverse impact on the rights of the assessee. Therefore, the Assessing Officer was directed to grant credit for tax deducted at source, in accordance with the law." [Para 10]

Respectfully following the coordinate bench decision,we direct AO to give credit to the tax deducted at source. Accordingly ground No.13 is allowed.

60. Ground Nos. 14, 15 16 pertain to levy of interest u/s. 234A, 234B and 234D. It was submitted that there was TDS on payment made to assessee Lucent Technologies GRL LLC by Reliance and therefore, there is

no liability u/s. 234B. Issue is also covered in favour of the assessee by the decision of *Hon'ble Bombay High Court* in the case of *DIT (Intl. taxation) vs. NGC Networks Asia LLC (313 ITR 187).* In that case it was held that when a duty was cast on the payer to deduct the tax at source, on failure of the payer to do so, no interest could be imposed on assessee. However, in this case TDS was already made while paying to the assessee Lucent, eventhough Assessing Officer denied credit for certain administrative reasons. Since the amount was covered by TDS question of levy u/s. 234B does not arise. Issue of 234A and 234D are consequential in nature. Therefore does not require any adjudication. Accordingly, ground No.14 and 16 are rejected and ground No.15 is allowed.

61. Ground No.17 is with respect to penalty. The assessee is contesting the initiation of penalty proceedings u/s. 271(1)(c). There is no right of appeal on initiation of proceedings and since proceedings are not yet finalized, it is little pre-mature to contest. This ground does not require any adjudication.

62. In the result, four appeals of Lucent are partly allowed.

ITA No.5374/M/07 and ITA No.6093/ M/ 08.

63. The issue in these two appeals of the Revenue is with reference to the payments made to M/s. New Skies Satellite N.V., Hague, Netherland for purchase of satellite Band width capacity, as per agreement dated 12.12.2002, subsequently amended on 18.12.2002. Reliance approached Assessing Officer for making payment without deduction of tax. Assessing Officer examined the issue and held that the payment being made was royalty and tax was required to be deducted at source. After deducting the tax, Reliance approached ld. CIT(A) in appeal to submit that the amount paid can not be considered as royalty and since the said company did not have a PE in India there is no tax. It relied on the decision of *DCIT vs. Pan Amsat International Systems Inc. (103 TTJ 861)* to submit that payments for

purchase of band width is not royalty income but only business income. The ld. CIT(A) while noting down that AO relied on the decision of ITAT in the case of *Asia Satellite Telecommunications Co. Ltd. vs. DCIT (85 ITD 478)* however, relied on the above referred decision in the case of DCIT vs. Pan Amsat International Systems Inc. (supra) and also the decision of Bangalore Bench in the case of Software Technology Parks of India vs. Income Tax Officer (3 SOT 529) and also interpreting the payments in the case of subscriber fee for cellular mobile telephone facility of *Skycell Communication Ltd. vs. DCIT (251 ITR 053)* held that purchase of bandwidth can not be considered as royalty and is to be considered as business profit. Since M/s. New Skies Satellite does not have a PE in India, its business profits are not taxable in India. Revenue is aggrieved and has raised the following grounds.

ITA No.5374/Mum/07

> "1. On the facts and in the circumstances of the case and in law, the ld. CIIT(A) erred in deciding that AO was not justified in the case in directing to deduct tax at source u/s. 195 of the IT Act.
>
> 2. On the facts and in the circumstances of the case and in law, the ld. CIIT(A) erred in holding that no income accrues to M/s. New Skies Satellites N.V. Rooseveltplantsoen 4, 2517 KR, The Hague, The Netherlands in India against the payment of US$17,00,000/- per annum for the supply of satellite bandwidth for use in the Reliance Telecom Network.
>
> 3. On the facts and in the circumstances of the case and in law, the ld. CIIT(A) failed to appreciate that the payment for obtaining computer software is in the nature of royalty which is liable for taxation in India.

ITA No.6093/Mum/08

> 1. On the facts and in the circumstances of the case and in law, the ld. CIIT(A) erred in holding that the payment made to M/s. New

Skies Satellite N.V. for purchase of certain telecommunication Satellite Band Width Capacity (Software) amounts to business receipts and in the absence of any Permanent Establishment in India, the business profit arising in the transaction is not taxable in India.

2. On the facts and in the circumstances of the case and in law, the ld. CIIT(A) failed to appreciate that the payment for the purchase of software is in the nature of "Royalty" which is liable for taxation in India.

3. The appellant prays that the order of the ld. CIT(A) on the above grounds be set aside and that of the AO restored."

64. These two cases were also argued along with other group cases. On this set of facts, the issue is not purchase of software but purchase of bandwidth for providing transponder capacity to telecommunication companies. The case was decided by Special Bench of ITAT, in *New Skies Satellite N.V. vs. ADIT (Intl. taxation) in 319 ITR (AT) 269 (Del.)(SB),* wherein it was held that service rendered amounts to royalty. The facts and decision of the *Special Bench of the ITAT* is as under :-

The assessees were non-resident satellite companies and earned income from telecasting companies in India for providing them transponder capacity. The assessee were engaged in operating telecommunication satellites which were called geostationary satellites and were placed at the distance of around 36,000 kms. From the equator. A satellite could typically consist of 20 to 30 trnasponders, each operating on a particular frequency within a frequency range allocated to that satellite. Through such transponders installed at satellite, the assessee's provided transponder capacity of data transmission to their customers, which were telecasting companies /telecom operators. In turn, the telecasting companies/ telecom operators provided broadcasting/telecommunication services to their customers. The telecasting companies/telecom operators while relaying the programmes whether live or recorded to their customers and used their earth stations to uplink the data to satellite *which was received by their earth stations in the downlinking process from where these telecasting companies/telecom operators provided the telecasting facilities to their customers. These telecasting companies /telecom operators entered into agreements with these assessees for obtaining transponder's capacity to enable themselves to uplink and downlink the programmes to be telecasted. For obtaining such transponder capacity and agreed amount was to be paid periodically as stated in the respective agreements. These receipts were taxed by the Department as "royalty" either under the provisions of the Income-tax Act, 1961 or under the provisions of the respective Double Taxation Avoidance Agreement.*

On appeal to the Tribunal.

Held, by the Special Bench of the Tribunal, that process was involved in the transponder through which the telecasting companies were able to uplink the desired images/data and downlink it in the desired area which, inter alia, covered Indian territory. For holding that consideration was received in respect of royalty, it was not necessary that the instruments through which the process was carried on should be in the control or possession of the person who is receiving the payment. The context and factual situation had to be kept in mind while finding out whether a process was actually used by the payer. In the case of satellites, physical control and possession of the process could neither be with the satellite companies nor with the telecasting companies. The control of the process, by either of them could be through sophisticated instruments either installed at the ground stations owned by the satellite companies or through the instruments installed at the earth stations owned and operated by the telecasting companies. The use of process, according to agreement, was provided by the satellite companies to the telecasting companies whereby the telecasting companies were enable to telecast their programmes by uplinking and downlinking the same with the help of that process. The *time of telecast and the nature of programme, all depended upon the telecasting companies and, thus, they were using that process. The term "secret" appearing in the phrase " secret formula or process" in Explanation 2 to section 9(1) (vi) and in the relevant article of the Double Taxation Avoidance Agreement does not qualify the work "process". Therefore, to fall within the meaning of royalty as envisaged in these provisions, it is not necessary that the services rendered must be through "secret process" only. The consideration received by the assessee for the use of the "process" in transponder, even if it was not protected, would be covered within the definition of "royalty" as the provisions do not specify the process to be protected. Even services rendered through simple process will be covered within the meaning of royalty. The payments received by the assessee from their customers were on account of use of process involved in the transponder and they amounted to royalty within the meaning of clause (iii) and (vi) of Explanation 2 to section 9(1)(vi) of the Income tax Act, 1961. they also amounted to royalty within the meaning of the respective articles of the Double Taxation Avoidance Agreements.*

Respectfully following the above decision of the Special Bench, we hold that the payment made by Reliance to New Skies Satellite N.V. is in the nature of royalty and taxable in India. Therefore Assessing Officer's order is to be upheld. Consequentially orders of CIT(A) are set aside and that of AO restored.

65. In the result, Revenue appeals in ITA Numbers-

837/M/07,	5076/M/08,	5077/M/08,	5078/M/08,	5079/M/08
5080/M/08,	5081/M/08,	5082/M/08,	5083/M/08,	5084/M/08
5085/M/08,	5086/M/08,	5087/M/08,	5088/M/08,	5089/M/08,
5090/M/08,	5091/M/08,	5092/M/08,	5467/M/08,	5469/M/08,
5470/M/08,	5474/M/08,	5475/M/08,	5476/M/08,	5477/M/08,
6093/M/08,	3431/M/08,	3432/M/08,	3433/M/08,	3434/M/08,
3435/M/08,	3436/M/08,	3437/M/08,	3438/M/08,	3439/M/08,
3440/M/08,	3441/M/08,	3442/M/08,	3443/M/08,	3444/M/08,
4278/M/08,	4279/M/08,	4280/M/08,	4281/M/08,	4282/M/08,

4283/M/08,	4284/M/08,	4285/M/08,	4286/M/08,	4287/M/08,
4244/M/08,	4245/M/08,	4246/M/08,	4247/M/08,	4248/M/08,
4249/M/08,	4250/M/08,	4251/M/08,	4252/M/08,	4253/M/08,
4254/M/08,	4255/M/08,	4256/M/08,	4257/M/08,	4258/M/08,
4259/M/08,	4260/M/08,	4261/M/08,	4291/M/08,	4305/M/08,
4306/M/08,	4307/M/08,	4308/M/08,	4309/M/08,	4310/M/08,
4873/M/07,	4874/M/07,	4875/M/07,	4876/M/07,	4877/M/07,
4878/M/07,	4899/M/07,	4900/M/07,	4901/M/07,	4902/M/07,
4903/M/07,	4904/M/07,	4905/M/07,	4906/M/07,	4907/M/07,
4908/M/07,	4909/M/07,	4910/M/07,	4916/M/07,	4917/M/07,
4918/M/07,	4919/M/07,	4920/M/07,	4921/M/07,	4922/M/07,
4923/M/07 ,	4924/M/07,	4925/M/07,	4926/M/07,	4927/M/07,
4928/M/07,	5373/M/07,	5374/M/08,	4672/M/07,	4673/M/07,
4674/M/07,	4675/M/07,	4676/M/07,	4677/M/07,	5071/M/08,
5072/M/08,	5073/M/08,	5074/M/08,	5075/M/08.	5468/M/08,
5471/M/08,	5472/M/08,	5473/M/08,	729/M/09,	4501/M/09,
730/M/09,	5093/M/08,	5094/M/08,	5095/M/08,	5096/M/08.

are allowed. ITA Nos. 7001/M/10, 7002/M/10, 7003/M/10, 7004/M/10 For Asst. Years 2003-04, 2004-05, 2005-06 & 2007-08 of Lucent are partly allowed.

Order pronounced in the open court on 6th September, 2013.

Sd/-
(Vivek Verma)
Judicial Member

Sd/-
(B. Ramakotaiah)
Accountant Member

Mumbai, Dated: 6th September, 2013

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT(A) – 39, Mumbai*
4. *The CIT– Central-II, Mumbai City*
5. *The DR, "A" Bench, ITAT, Mumbai*

By Order

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