IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 15 TH DAY OF OCTOBER 2011

PRESENT

THE HON'BLE MR. JUSTICE V. G. SABHAHIT

AND

THE HON'BLE MR.JUSTICE RAVI MALIMATH

ITA No. 2808 /2005
C/w
ITA 2809 /2005, ITA 2810 /2005, ITA 1267 /2006,ITA 1265 /2006, ITA 1264 /2006, ITA 1062 /2006,ITA 1059 /2006, ITA 3080 /2005, ITA 3079 /2005, ITA 3078/2005, ITA 3077 /2005, ITA 3076 /2005, ITA 3075 /2005, ITA 1258 /2006, ITA 1268 /2006, ITA 1269 /2006, ITA 1270 /2006, ITA 609 /2006, ITA 610 /2006,ITA 611 /2006, ITA 612 /2006, ITA 265 /2006,ITA 266 /2006, ITA 1056/2006 & ITA 552-556/2009,ITA 2988/2005, ITA 2991/2005, ITA 1055/2006 & ITA 585-594/2009, ITA 1066/2006, ITA 1067/2006 & ITA 557- 575/2009, ITA 1053/2006 & ITA 611-613/2009, ITA 1060/2006 & ITA 595-604/2009, ITA 737/2007, ITA 739/2007, ITA 741/2007, ITA 745/2007, ITA 746/2007, ITA 747/2007, ITA 777/2007, ITA 780/2007, ITA 782/2007, ITA 785/2007, ITA 786/2007, ITA 787/2007, ITA 953/2007, ITA 1203/2006, ITA 1204/2006, ITA 1205/2006, ITA 1206/2006, ITA 1207/2006, ITA 1208/2006, ITA 1209/2006, ITA 1210/2006, ITA 1211/2006, ITA 1212/2006, ITA 1213/2006,ITA 1214/2006, ITA 1215/2006, ITA 1218/2006, ITA 1219/2006, ITA 1220/2006, ITA 1221/2006, ITA 1222/2006, ITA 1223/2006,ITA 1224/2006, ITA 2989/2005, ITA 738/2007, ITA 740/2007, ITA 921/2007 & ITA 503-532/2009, ITA 919/2007 & ITA 533-542/2009, ITA 1251/2006, ITA 1248/2006 & ITA 580-584/2009, ITA 1247/2006 & ITA 605-610/2009, ITA 1246/2006 & ITA 543-548/2009, ITA 94/2007 & ITA 650-656/2009, ITA 77/2007 & ITA 549-551/2009, ITA 1243/2006, ITA 1242/2006, ITA 1241/2006, ITA 1240/2006, ITA 1239/2006, ITA 1238/2006, ITA 1237/2006, ITA 1236/2006, ITA 1225/2006, ITA 1061/2006 & ITA 657-682/2009, ITA 1216/2006, ITA 1217/2006, ITA 1244/2006, ITA 1074/2006, ITA 606/2006 , ITA 2911/2005

I.T.A. No. 2808 OF 2005

BETWEEN:

1. THE COMMISSIONER OF INCOME TAX,
   INTERNATIONAL TAXATION,
   RASTROTHANA BUILDING,
   NRUPATHUNGA ROAD,
   BANGALORE.

2. THE INCOME –TAX OFFICER,
   TDS – I,
   RASTROTHANA BUILDING,
   NRUPATHUNGA ROAD,
   BANGALORE.

... APPELLANTS

(BY SRI M V SESHACHALA, ADV.)

AND:

M/S. SAMSUNG ELECTRONICS CO LTD
INDIA SOFTWARE OPERATIONS,
LEVEL 6TH AND 7TH,
PRESTIGE MERIDIAN-II,
NO. 30, M.G. ROAD,
BANGALORE.

... RESPONDENT

(BY SRI K P KUMAR, SR. ADV. FOR
M/S UNIVERSAL LEGAL ADVS.)

THIS ITA IS FILED UNDER SECTION 260-A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 18.02.2005 PASSED IN ITA NO. 266/Bang/2002 FOR THE ASSESSMENT YEAR 2001-02, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO: FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN, ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED

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## JUDGMENT

These appeals are disposed of by common order as they involve adjudication of the following substantial question of law as framed by the Hon'ble Supreme Court while remanding the proceedings to this Court in Civil Appeal Nos.7541 – 7542/2010 and connected matters, by setting aside the judgment passed by the Division Bench of this Court dated 24-9-2009.

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

2. The material facts of the case leading up to these appeals which are necessary for answering the above said question of law are as follows:

For the purpose of convenience, the facts in ITA No. 2808/2005 would be referred to.

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The assessee – respondent herein is engaged in the development of computer software and exports such software developed to its head office located in South Korea. During the assessment years 1999-2000 to 2001-2002, the respondent imported software products from USA, France and Sweden. During the financial years 1998-1999, 1999-2000 and 2000-2001, relevant for the assessment years 1999-2000, 2000-2001 and 2001-2002, the assessee made payment of Rs.2,28,960/-, Rs.10,825/- and Rs.151,85,430/- respectively for importing software from non-resident companies of USA, France and Sweden. No tax was deducted at source in respect of such payments. As the Income Tax Officer was of the view that the appellant ought to have deducted the tax at source regarding such payments, he asked the assessee as to why tax was not deducted at source. The Manager ( Finance ) of the respondent-company appeared before the ITO (TDS) and filed a letter dated 20-3-2001 stating therein details of the software imported during the period mentioned above and contending that the software imported by the company is shrink wrap product and the same is not customized and no tax was deducted as it was not taxable in India and as the payment does not constitute royalty under Section 9(1)(vi) of the Income Tax Act, 1961 (hereinafter called the 'Act') and also in terms of the provisions of DTA agreement since the payment was not chargeable in the hands of the non-resident assessee at USA, France and Sweden, no tax arose in India and therefore, there was no obligation to pay the tax. It was also contended before the Assessing Officer by the assessee that the software imported was not customized and therefore not liable to tax. The Assessing Officer after hearing the assessee passed a detail order and held that payment made by the assessee would constitute royalty under Section 9(1)(vi) explanation (2) of the Act and relevant clauses of the DTA agreement with USA, France & Sweden and therefore there was obligation to deduct tax at source under Section 195(1) of the Act and therefore for the default for non deduction of the advance tax which was payable by the non-resident assessee, the assessee respondent is liable to imposition of penalty and deducted tax at 10% of the value as the said percentage of tax was beneficial to the assessee as compared to tax imposed under the Act and DTA agreement.

3. Being aggrieved by the said order passed by the assessing officer, an appeal was filed before the Commissioner of Income Tax (Appeals)-V in appeal No.ITA 17/TDS/CIT(A)V/2001-02 wherein the appellate authority confirmed the order passed by the assessing officer holding that payment made to the non resident companies was taxable in India and therefore non deduction of TDS under Section 195(1) of the Act would make liable the respondent to treat the same as income and therefore the respondent would be liable for default for non deduction of tax at source and dismissed the appeal. Being aggrieved by the said order, the respondent filed an appeal before the Income Tax Appellate Tribunal, Bangalore (hereinafter called the 'Tribunal') in ITA Nos. 264 to 266/Bang/2002 and the Tribunal by order dated 18-12-2005 allowed the appeal by setting aside the order passed by the appellate authority confirming the order passed by the Assessing Officer and held that payment made by the respondent to the non-

resident company would not amount to royalty within the meaning of Section 9(1)(vi) of the Act or under Clauses of DTAA and it was a purchase of shrink wrap software and since there was no permanent establishment of non resident company in India, the payment was not liable to be deducted. Being aggrieved by the same, ITA Nos.2808/2005 and other appeals were filed against the said order of the Tribunal and Division Bench of this Court by order dated 24-9-2009 set aside the order of the Tribunal by holding that all payments made to the non-resident company should be deducted at source unless certificate is obtained by making an application under Section 195(2) of the Act that there is no liability to deduct tax at source and accordingly allowed the appeals filed by the revenue by setting aside the order passed by the Tribunal. The respondent and others who are aggrieved by the common order dated 24-9-2005 passed by this Court in ITA No.2808/2005 and connected cases filed Civil Appeal Nos.7541-7542/2010 and connected matters before the Hon'ble Supreme Court and the Hon'ble Supreme Court by order dated 9-9-2010 set aside the order passed by the Division Bench of this Court by analyzing the provisions of Section 195 of the Act and remitted the matter to this Court for answering the substantial questions of law framed by it as referred to above. Accordingly, these appeals are posted for hearing before us for answering the aforementioned substantial question of law.

4. We have heard the learned standing counsel appearing for the appellants and learned Sr.counsel appearing for the respondents and reply arguments.

5. Sri M V Seshachala, learned Standing Counsel appearing for the appellants submitted that the respondents have failed to deduct the tax payable in India towards payment made to the non-resident assessee even though the payments made by them is royalty within the meaning of Section 9(1)(vi) explanation (2) of the Act and Article 12 and other relevant clauses in DTAA agreement with the respective country in which the assessee is located and therefore the said deduction is to be made and treated as the revenue of respondent-company under Section 201 of the

Act. He has taken us through the provisions of Sections 4,5,9,195, 401 & 201 of the Act.

He further submitted that the payment made by the respondent falls within the definition of the term 'royalty' within the meaning of Section 9(1)(vi) read with explanation (2) and relevant clause under Article 12 of the DTAA agreement with USA and relevant clauses under the DTAA with the other countries in which non-resident assessee is located. He submitted that the fact that the payment has been made by the respondent-company in each of the appeals to the non-resident company is not disputed. The said payment has been made in view of the use of the copyrighted article i.e., shrink wrapped software and in view of the definition of royalty under explanation (2) to Section 9(1)(vi) of the Act, it is clear that royalty means consideration including any lumpsum consideration for transfer of all or any rights for imparting any information concerning the working of, or the use of, a patent, invention, model, design or process or and imparting any information concerning technical, scientific knowledge, experience or skill and thereof for the consideration of the payment made by the assessee, the respondent company is licenced to use the copy right work in which copy right vests with the non-resident assessee and the agreement entered into with the non-resident assessee company would clearly show that copy right is to prepare a copy for the effective use of the software by unloading the software in the hard disk of the computer and it is restricted in the agreement to one computer and also to take copy for the back up. Therefore, the said right which is conferred by way of licence or permission which would not have been available but for the licence or permission, would amount to payment of royalty as the respondent company is using the copy righted work and information pertaining to scientific formula and therefore payment could be only royalty and it cannot be sale as no copy right or any part of the copy right is sold to the respondent-company. The learned counsel submitted that in view of the definition of royalty under Article 12 under the DTAA which is narrower than the definition of the term 'royalty' under explanation (2) of Section 9(1)(vi) of the Act,

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the payment is covered as royalty and cannot be considered as sale and he further submitted that even if it is considered as sale, it would be a part of the business income and existence of the permanent establishment in India is not necessary. He has relied upon the following decisions:

1) (2010) 323 ITR 211
AIRPORTS AUTHORITY OF INDIA, IN RE

2) (2008) 304 ITR 216
AIRPORTS AUTHORITY OF INDIA, IN RE

3) (2004) 267 ITR 727 (AAR)
FLAKT (INDIA) LTD., IN RE

4) (2009) 312 ITR 317
WORLEY PARSONS SERVICES PTY.LTD
IN RE

5) (2007) 289 ITR 355 (AAR)
CARGO COMMUNITY NETWORK PTE LTD
IN RE

6) (1999) 238 296 (AAR)
XYZ, IN RE

7) (1999) 238 ITR 296 (AAR)
ABC, IN RE

8) ITA NO.1331/Del/2008 DTD. 26-10-2010
(DEL) M/S.GRACEMAC CORPORTION vs
ADIT, NEW DELHI

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ITA NO.1392/DEL/2005 DTD 26-10-2010 (DEL) M/S.MICROSOFT CORPORATION vs ADIT, NEW DELHI

9) W.P.NO.3811 & 18886/2009 DT. 24-8-2010 (MAD) INFOTECH SOFTWARE DEALERS ASSOCIATION vs UNION OF INDIA & OTHERS

10)W.P.(C)NO.9937/2005 DTS. 23-4-2008 (DEL) M/S.PANACEA BIOTECH LTD vs DDA & ANOTHER

The learned counsel for the revenue further submitted that the Tribunal was not justified in relying upon the decision in TATA CONSULTANCY SERVICES vs STATE OF ANDHRA PRADESH (2004) 271 ITR 404), wherein the Hon'ble Supreme Court was considering the question as to whether the transaction in question was sale for the purpose of Andhra Pradesh General Sales Tax, 1957 and the same would not apply to the respondents in these cases to contend that payment is not royalty and the transaction amounts to sale and for the same reasons, the Tribunal was also not justified in relying upon the other decisions. The learned counsel further submitted that the assessing officer has passed a detailed order giving the reasons as to why the payment made by the respondent to non resident assessee is a royalty and was deductible under Section 195 of the Act and the appellate authority has confirmed the same by writing a detailed order with reference to OECD commentary and has held that payment made by the respondent was royalty and there was concurrent finding on the said question of fact and the same could not have been disturbed by the Tribunal and that the order of the Tribunal holding that payment is not royalty and though it is sale, it is not taxable as the respondent-assessee has no permanent establishment in India is erroneous and is liable to be set aside by holding that payment made by the respondent to the non-resident assessee is royalty and accordingly, substantial question of law may be answered in favour of the revenue.

6. The learned Sr.counsel Sri K P Kumar appearing for respondent in ITA No.2808/2005 and connected appeals submitted that payment made by the respondent to non-resident company can never be treated as royalty. He submitted that the software so secured was used in testing the software developed by the respondent to ensure that the

software developed conformed to the requirements of its parent company and bonafide enquiry was made for making payment and under the bonafide impression that payment did not constitute royalty and no deduction has been made and rightly accordingly to the learned counsel, as no copy right or part of any copy right has been licenced to the respondent and what has been purchased is only shrink wrapped software and at the most it may amount to sale of the software which will be a constituent of business income of the non-resident company. However, the said income would not be taxable in India as the non-resident company to whom the payment has been made is not having any permanent establishment in India. He submitted that in TATA CONSULTANCY SERVICES vs STATE OF ANDHRA PRADESH, the Supreme Court was considering the identical transaction and has held that such transaction i.e., transfer of incorporeal right in the software wherein copyright remains with the originator and what is sold is a copy of the copyrighted software and when one buys such copy of copyrighted software, he only acquires ownership of that particular copy but not the intellectual property in the copyright and therefore it would be a sale within the meaning of Article 366(12) of the Constitution of India and payment would not satisfy the requirement of Section 9(1)(6) read with explanation (2) of the provisions of the Act or Article in the DTAA as the definition of royalty under the DTAA is restrictive. The learned Sr.counsel further submitted that the case of the respondent is that only copies of the software was secured by the respondent and respondent did not secure any right whatsoever in the copyrighted software as noted and found as a fact by the Tribunal and in view of the OECD model commentary on the subject and commentary of Klaus Vogel on Double Taxation Conventions, the purchase price of the software is not in the nature of royalty and as such not taxable in India to warrant tax deduction at source. In terms of Section 90(2) of the Act, the Hon'ble Supreme Court in UNION OF INDIA vs AZADI BACHAO ANDOLAN & ANOTHER (263 ITR 706) and CIT vs P.V.A.L. KULANDAGAN CHETTIAR (267 ITR 654), COMMISSIONER OF INCOME TAX vs ORACLE SOFTWARE

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INDIA LTD ((2010) 320 ITR 546), DASSAULT SYSTEMS K.K. In Re ((2010) 322 ITR 125 (AAR) and GEOQUEST SYSTEMS B.V., In Re ((2010) 327 ITR 1 (AAR) held that payment can never be construed as royalty and it would be a sale and since admittedly non-resident assessee is not having permanent establishment in India, the payment would not be taxable and therefore, there is no obligation to deduct tax. The learned counsel submitted that the transaction was not covered by any licence or assignment under the Indian Copy right act and therefore, it cannot be construed as licence though the term 'licence' has been used in the agreement, it connotes sale of the shrink wrapped product sale. He submitted that the contention of learned counsel appearing for the appellant that definition of royalty in TCS's case was considered only for the purpose of sale under Article 366(12) of the Constitution of India is not correct and similar transaction is held to be a sale in the said case and the same has been followed in CIT vs ORACLE SOFTWARE INDIA PVT LTD (320 ITR 546). He further submitted that the appellant is not entitled to contend that the word 'use' used in explanation (2) to Section 9(1)(vi) of the Act means copying of any portion of software into a machine and then processing of the machine instructions, etc.,. and can never be accepted in view of the decision of the Supreme Court in STATE BANK OF INDIA vs COLLECTOR OF CUSTOMS {(2000)1 SCC 727} as relied upon by the learned counsel appearing for the appellant and it is well settled in view of the decision of the Hon'ble Supreme Court in CIT vs SUN ENGINEERING WORKS PVT.LTD (198 ITR 297) that the word 'use' in the statute cannot be taken out, divorced from the context of question under consideration and therefore, the transaction pertaining to the payment made to the non-resident assessee can never be termed as royalty. He further submitted that the decision relied upon by the learned counsel appearing for the appellant is not helpful to him in the present case as in the said case transaction was not similar. He further submitted that if payment is made for purchase of a copyrighted software without any right whatever in the copyright being conferred on the purchaser either by assignment of a right in the copyright or grant of a licence to use the copyright, is said to fall within the scope of explanation -2 (v) to Section 9(1)(vi) of the Act, it will have a devastating effect and result in wholly unintended consequences and in terms of Section 194J of the Act, if a resident makes payment of royalty to another resident, he has to deduct income tax at source at 10%. Accordingly, he submitted that contention of the learned counsel appearing for the revenue may be rejected and substantial question of law may be answered in favour of the respondent against the revenue.

7. Sri G Sarangan, learned Sr.counsel appearing for the respondent in ITA No.609/2006 and connected matters, submitted that the respondent in the appeals is the distributor of software not only of the respondent-assessee in other cases but also of 16 companies and he only places contract to take orders with the non-resident company after receiving the orders from the customers and supply of the goods (shrink wrapped software) available on the shelf is sufficient/sanctioned to the respondent for handing over the same to the customer and the name of the customer is also

stated in the invoice and in some cases was directly sent to the customer and therefore, distributor by himself does not keep any right in the copyright or keep any use in the copy righted article and therefore, payment can never be termed as royalty. The learned Sr.counsel apart from reiterating the submissions made by the learned counsel Sri K P Kumar, further submitted that licence has been defined under Section 52 of the Easement Act as the permission to do something which, but for the permission would be unlawful and Section 52(a)(a) of the Copyright Act expressly permits the purchaser of a software package to copy it on his computer and also to make a back-up copy. Therefore, the statutory right of the purchaser/end user of the software package, even if no licence or permission is granted by the copyright owner to the end user as the making of a copy by the end user is not unlawful, the formal permission given to him by the copyright owner is not even a licence as defined by section 52 of the Easements Act and consequently, section 14(b)(i) of the Copyright Act is not attracted. The OECD commentary treats the said permission to make a copy as merely incidental to the sale of the software package and as essential to effectuating the sale and as not constituting a use of the copyright at all and in view of the decision of the Authority for Advance Ruling in DASSAULT SYSTEMS K.K. In Re reported in (2010) 322 ITR 125 and also the decision of the Authority for Advance Ruling in GEOQUEST SYSTEM B.V., In Re (2010) 327 ITR 1, relied upon by the learned counsel Sri K P Kumar, it is clear that payments can never be treated as royalty. He further submitted that Section 14(b)(ii) of the Act would only apply if the respondent-assessee has been given a right to sell or offer for sale a computer program and the payment made to the non-resident company can never be termed as royalty in view of explanation(2) to Section 9(1)(vi) of the Act or Clauses under DTAA with the non-resident company of the country wherein the non-resident company is situated. He submitted that the decision relied upon by the learned counsel appearing for the appellant is not helpful to the revenue in the present case in view of the fact that there is no permanent establishment of the assessee-company and

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the payment made is not taxable in India and therefore there was no obligation to deduct tax under the Act and question of making deduction would not arise and the Tribunal, after detailed consideration of all the contentions urged has rightly held that payment made by the resident-company would not amount to royalty and it was a sale and since the non-resident company has no permanent establishment in India, income is not taxable and therefore not deductible under Section 195(1) of the Act and consequently, the order passed by the Tribunal may be confirmed by answering the substantial question of law against the revenue and in favour of the assessee.

8. Sri Aravind Datar, learned Sr.counsel appearing for the respondent in ITA Nos.3080/2005 and connected matters reiterated the arguments submitted by Sri K.P.Kumar, Sri Sarangan and further submitted that the substantial question of law had already been answered by the Delhi High Court in COMMISSIONER OF INCOME TAX APPEAL – V vs M/S.DYNAMIC VERTICAL SOFTWARE INDIA PVT LTD (ITA NO.1692/2010 DECIDED ON 22-2-2011) and

therefore, payment made by the respondent-company to the non-resident assessee can never be treated as royalty.

9. Sri Ganesh, learned Sr.counsel appearing for the respondent in ITA Nos.1056/2006 and connected matters submitted that in view of Section 90 of the Act, provisions of DTA agreement would prevail and since the payment made by the respondent-company would not amount to royalty as defined in the said agreement, it is unnecessary to look into the question whether the amount would fall within the ambit of royalty as defined under Section 9(1)(vi) explanation (2) of the Act. Even otherwise, as the definition of royalty under the DTA agreement has got a restrictive meaning than the definition of royalty under the Act, he further submits that commentary of OECD is important in interpreting clauses/Articles in DTAA and the Tribunal having considered the said commentary and also the observations made by the renowned author Klaus Vogel on Double Taxation Conventions which have been referred to by the Courts while interpreting the Article by the DTA would clearly show that payments made for purchase of shrink

wrapped software can never be a royalty and it may at the most, amount to sale and proceeds of sale could not be taxable in India as there is no permanent establishment of non-resident assessee in India. In support of his contention, he has relied upon the OECD commentary and definition of 'royalty' under the DTAA and submitted that payment made for purchase of shrink wrapped software which is like purchasing a book from the shop, can never be termed as a 'royalty' and therefore substantial question of law may be answered in favour of the assessee against the revenue holding that payment made by the respondent-company is not 'royalty'. The learned counsel further submitted that the respondent in the appeals is representing as only distributor who receives purchase orders from the customers and forwards the same to non-resident company and places back to back order and only receives 2% commission from the non-resident assessee and he does not make any payment and he does not acquire any right to use copyrighted article nor make any payment for 'royalty' and the payment is made by the customer and he does not even open the shrink

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wrapped software and even without reading of terms and conditions in the agreement for the sale of shelf shrink wrapped software, he hands over the goods to the customers and therefore amount paid towards the said transaction made by the respondent-company to the non-resident assessee cannot be taxed in India and accordingly the substantial question of law may be answered against the revenue and in favour of the assessee. He has reiterated the arguments of the learned Sr.counsel appearing for the respondents in other cases.

10. In reply, the learned counsel appearing for the appellant submitted that payment made by the respondent would amount to royalty even assuming that it is sale as contended by the respondents, it is not necessary that the said payment would be taxable in India even if the non-resident assessee has no permanent establishment in India. In support of his contention, he has taken us through the provisions of Section 9(1)(vi) of the Act and submitted that decisions relied upon by the learned Sr.counsel appearing for the respondents are not helpful to contend that payment

made in the present cases by the respondents to the non-resident assessee is not royalty and accordingly reiterated that substantial question of law may be answered in favour of the revenue and against the assessee.

11. We have given careful consideration to the contentions of learned counsel appearing for the appellant and learned Sr.counsel appearing for the respondents' in all the appeals and carefully scrutinised the material on record with reference to the principles laid down by the Hon'ble Supreme Court and other High Courts and the decisions relied upon by learned counsel appearing for the parties.

12. Before considering the contentions of learned counsel appearing for the parties, it is necessary to bear in mind the decision rendered by the Division Bench of this Court by order dated 24-2-2009 wherein the Division Bench considered the appeal on merits and held that payment made was royalty within the meaning of the Act and therefore adjudicated by holding that all payments made to the non-resident assessee are to be deducted at source

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unless the respondent-company has obtained exemption from deducting the said tax as royalty under Section 195 of the Act and accordingly, allowed the appeals by answering the issue in favour of the appellant.

13. Civil Appeal Nos. 7541-7542/2010 and connected appeals were filed before the Hon'ble Supreme Court and the Hon'ble Supreme Court by order dated 9-9-2010 has set aside the order passed by this Court dated 24-9-2009 and remitted the matter for consideration of the following substantial question of law:

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

While remanding the matter, Hon'ble Supreme Court has made certain observations while analysing the provisions of Section 195 of the Act as follows:

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7. Under Section 195(1), the tax has to be deducted at source from interest (other than interest on securities) or any other sum (not being salaries) chargeable under the I.T. Act in the case of non-residents only and not in the case of residents. Failure to deduct the tax under this Section may disentitle the payer to any allowance apart from prosecution under Section276B. Thus, Section 195 imposes a statutory obligation on any person responsible for praying to a non-resident, any interest (not being interest on securities) or any other sum (not being dividend) Chargeable under the provisions of the I.T. Act, to deduct income tax at the rates in force unless he is liable to pay income tax thereon as an agent. Payment to non-residents by way of royalty and payment for technical services rendered in India are common examples of sums chargeable under the provisions of the I.T Act to which the aforestated requirement of tax deduction at source applies. The tax so collected and deducted is required to be paid to the credit of Central Government in terms of Section 200 of the I.T. Act read with Rule 30 of the I.T. Rules 1962. Failure to deduct tax or failure to pay tax would also render a person liable to penalty under Section 201 read with Section 221 of the I.T. Act. In addition, he would also be liable under Section 201 (1A) to pay simple interest at 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. The most important expression in Section 195(1) consists of the words **"Chargeable under the provisions of the Act".** A person paying interest or any other sum to a non-resident is not liable to deduct tax if such is not chargeable to tax under the I.T. Act. For instance, where there is no obligation

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on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the I.T. Act. It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, " chargeable under the provisions of the Act". It is for this reason that vide Circular No. 728 dated October 30, 1995 the CBDT has clarified that the tax deductor can take into consideration the effect of while deducting TAS. It may also be noted that Section 195(1) is in identical terms with Section 18(3B) of the 1922 Act. In **CIT Vs. Cooper Engineering** (68ITR 457) it was pointed out that if the payment made by the resident to the non-resident was an amount which was not chargeable to tax in India, then no tax is deductible at source even though the assessee had not made an application under Section 18(3B) (now Section 195(2) of the I.T. Act). The application of Section 195(2) pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure

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as to what should be the portion so taxable or is not sure as to the amount of tax to be deducted. In such a situation, he is required to make an application to the ITO (TDS) for determining the amount. It is only when these conditions are satisfied and an application is made to the ITO (TDS) that the question of making an order under Section 195(2) will arise. In fact, at one point of time, there was a provision in the I.T. Act to obtain a NOC from the Department that no tax was due. That certificate was required to be given to RBI for making remittance. It was held in the case of **Czechoslovak Ocean Shipping International Joint Stock Company Vs. ITO** 81 ITR 162 (Calcutta)] that an application for NOC cannot be said to be an application under Section 195(2) of the Act. Which deciding the scope of Section 195(2) it is important to note that the tax which is required to be deducted at source is deductible only out of the chargeable sum. This is the underlying principle of Section 195. Hence, apart from Section 9 (1), Sections 4, 5, 9, 90, 91 as well as the provisions of DTAA are also relevant, while applying tax deduction at source provisions. Reference to ITO(TDS) under Section 195(2) or 195(3) either by the non-resident or by the resident payer is to avoid any future hassles for both resident as well as non-resident. In our view, Sections 195(2) and 195(3) are safeguards. The said provisions are of practical importance. This reasoning of ours is based on the decision of this Court in **Transmission Corporation** (supra) in which this safeguard. From this it follows that where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof.

The Supreme Court after considering the submissions of learned counsel appearing for the parties regarding the validity of the order passed by this Court dated 24-9-2009 has observed as follows:

> 9. One more aspect needs to be highlighted. Section 195 falls in Chapter XVII which deals with collection and recovery. Chapter XVII-B deals with deduction at source by the payer. On analysis of various provisions of Chapter XVII one finds use of different expressions however, the expression "sum chargeable under the provisions of the Act" is used only in Section 195. For example, Section 194C casts an obligation to deduct TAS in respect of 'any sum paid to any resident". Similarly, Sections 194EE and 194F inter alia provide for deduction of tax in respect of "any amount" referred to in the specified provisions. In none of the provisions we find the expression "sum chargeable under the provisions of the Act", which as stated above, is an expression used only in Section 195(1). Therefore, this Court is required to give meaning and effect to the said expression. It follows, therefore, that the obligation to deduct TAS arises only when there is a sum chargeable under the Act. Section 195(2) is not merely a provision to provide information to the ITO(TDS). It is a provision requiring tax to be deducted as source to be paid to the Revenue by the payer who makes payment to a non-resident. Therefore, Section 195 has to be read in conformity with

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the charging provisions, i.e., Section 4, 5 and 9. This reasoning flows from the words "sum chargeable under the provisions of the Act" in Section 195(1). The fact that the Revenue has not obtained any information per se cannot be a ground to construe Section 195 widely so as to require deduction of TAS even in a case where an amount paid is not chargeable to tax in India at all. We cannot read Section 195, as suggested by the Department, namely, that the moment there is remittance the obligation to deduct TAS arises. If we were to accept such a contention it would mean that on mere payment income would be said to arise or accrue in India. Therefore, as stated earlier, if the contention of the Department was accepted it would mean obliteration of the expression "sum chargeable under the provisions of the Act" from Section 195(1). While interpreting a Section one has to give weightage to every word used in that section. While interpreting the provisions of the Income Tax Act one cannot read the charging Sections of that Act de hors the machinery Sections. The Act is to be read as an integrated code. Section 195 appears in Chapter XVII which deals with collection and recovery. As held in the case of **C.I.T. Vs. Eli Lilly & Co. (India) (P.) Ltd.** [312 ITR 225] the provisions for deduction of TAS which is in Chapter XVII dealing with collection of taxes and the charging provisions of the I.T. Act form one single integral, inseparable Code and, therefore, the provisions relating to TDS applies only to those sums which are "chargeable to tax" under the I.T. Act. It is true that the judgment in Eli Lilly (supra) was confined to Section 192 of the I.T. Act. However, there is some similarity between the two. If one looks at Section 192 one finds that it imposes statutory obligation on the payer to deduct TAS when he



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pays any income " chargeable under the head salaries". Similarly, Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident any sum "chargeable under the provisions of the Act", which expression, as stated above, do not find place in other Sections of Chapter XVII. It is in this sense that we hold that the I.T. Act constitutes one single integral inseparable Code. Hence, the provisions relating to TDS applies only to those sums which are Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the moneys deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the I.T. Act by which a payer can obtain refund. Section 237 read with Section 199 implies that only the recipient of the sum, i.e., the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum changeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act" to be omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when the income has no territorial nexus with India or is not chargeable in India, the Government would nonetheless collect tax. In our view, Section 195(2) provides a remedy by which a person may seek a determination of the "appropriate proportion of such so chargeable" where a proportion of the sum so chargeable is liable to tax. The entire basis of the Department's contention is based on administrative convenience in support of its interpretation. According to the Department huge seepage of revenue can take place if persons making payments to non-residents are free to deduct TAS or not to deduct TAS. It is the case of the Department that Section 195(2), as interpreted by the High Court, would plug the loophole as the said interpretation requires the payer to make a declaration before the ITO(TDS) of payments made to non-residents. In other words, according to the Department Section 195(2) is a provision by which payer is required to inform the Department of the remittances he makes to the non-residents by which the Department is able to keep track of the remittances being made to non-residents outside India. Section 195(1) uses the expression "sum chargeable under the provisions of the Act". We need to give weightage to those words. Further, Section 195 uses the word 'prayer' and not the word "assessee". The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfill the statutory obligation under Section 195(1). If the payment does not contain the element of income the payer cannot be made liable. He cannot be declared to be an assessee-in-default. The above mentioned contention of the Department is based on an apprehension which is ill founded. The payer is also an assessee under the ordinary provisions of the I.T. Act. When the payer remits an amount to a non-resident out of India he claims deduction or allowances under the Income Tax

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Act for the said sum as an "expenditure". Under Section 40(a) (i), inserted vide Finance Act, 1988 w.e.f. 1.4.89, payment in respect of royalty, fees technical services or other sums chargeable under the Income Tax Act would not get the benefit of deduction if the assessee fails to deduct TAS in respect of payments outside India which are chargeable under the I.T. Act. This provision ensures effective compliance of Section 195 of the I.T. Act relating to tax deduction at source in respect of payments outside India in respect of royalties, fees or other sums chargeable under the I.T. Act. In a given case where the payer is an assessee he will definitely claim deduction under the I.T. Act for such remittance and on inquiry if the AO finds that the sums remitted outside India comes within the definition of royalty or fees for technical service or other sums chargeable under the I.T Act then it would be open to the AO to disallow such claim for deduction. Similarly, vide Finance Act, 2008, w.e.f. 1.4.2008 sub-Section (6) has been inserted in Section 195 which requires the payer to furnish information relating to payment of any sum in such form and manner as may be prescribed by the Board. This provision is brought into force only from 1.4.2008. It will not apply for the period with which we are concerned in these cases before us. Therefore, in our view, there are adequate safeguards in the Act which would prevent revenue leakage.

Further, the Hon'ble Supreme Court remitted the matter and framed substantial questions of law by holding as follows:

11. Before concluding we may clarify that in the present case on facts the ITO (TDS) had taken the view that since the sale of the concerned software, included a license to use the same, the payment made by appellants(s) to foreign Suppliers constituted "royalty" which was deemed to accrue or arise in India and, therefore, TAS was liable to the deducted under Section 195(1) of the Act. The said finding of the ITO(TDS) was upheld by the CIT(A). However, in second appeal, the ITAT held that such sum paid by the appellant(s) to the foreign software Supplier was not a "royalty" and that the same did not give rise to any "income" taxable in India and, therefore, the appellant(s) was not liable to deduct TAS. However, the High Court did not go into the merits of the case and it went straight to conclude that the moment there is remittance an obligation to deduct TAS arises, which view stands hereby overruled.

12. Since the High Court did not go into the merits of the case on the question of payment of royalty, we hereby set aside the impugned judgments of the High Court and remit these cases to the High Court for de novo consideration of the answer is- whether on facts and circumstances of the case the ITAT was justified in holding that the amount(s) paid by the appellant(s) to the foreign software Suppliers was not "royalty" and that the same did not give rise to any "income" taxable in India and, therefore, the appellant(s) was not liable to deduct any tax at source?

14. It is clear from the scrutiny of the material on record, the fact that respondent-company has imported

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software from the non resident is not in dispute. It is also not in dispute having regard to the contention of the assessee and the revenue and the counsel appearing for them that the assessee has acquired right to use the copyrighted article. It is also not in dispute that software which is in legal parlance called computer program is categorized as copyright in India and therefore software – computer program is copyrighted and copyright vests with the foreign supplier. However, substance of the argument of the revenue is that assessee was given right to use the software and the amount paid towards the same would constitute royalty within the meaning of Section 9(1)(vi) read with explanation (2) of the Act and relevant clauses of DTAA agreement. However, according to the assessee respondent-company in all the appeals, the payment made does not come within the purview of royalty under Section 9(1)(vi) of the Act or within the provisions of the Act or clauses in DTAA and what is purchased is an article which is taxable as business income and since exporter - non-resident is not having permanent establishment in India, such income which is accrued in India is not taxable, in any event, payment would not amount to royalty. Therefore, before considering the rival contentions of learned counsel appearing for the parties to find out as to whether the payment made by the respondent with foreign company would amount to 'royalty' or not, it is necessary to reproduce the definition 'royalty' and the circumstances under which the said payment is taxable in India so as to cast the obligation on the respondent-assessee to make deduction and also the provisions of DTAA in various countries regarding royalty.

15. It may also be noted at this stage itself that it is well settled that while considering the decision of the Hon'ble Supreme Court, the same cannot be considered dehors the context in which it was rendered and it is necessary to ascertain the ratio decidendi laid down in the said case. In COMMISSIONER OF INCOME TAX Vs. SUN ENGINEERING WORKS P. LTD. (Income Tax Reports 1992

VOL. (198) 297 ), the Hon`ble Supreme Court has held as under:-

> " It is neither desirable nor permissible to pick out a word or a sentence from the judgment of this court, divorced from the context of the question under consideration and treat it to be the complete "law" declared by this court. The judgment must be read as a whole and the observations from the judgment 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 not to pick out words or sentences from the judgment, divorced from the context of the questions under consideration by this court, to support their reasonings. In *Madhav Rao Jivaji Rao Scindia Bahadur v. Union of India* [1971] 3 SCR 9; AIR 1971 SC 530, this court cautioned (at page 578 of AIR 1971 SC):
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> > "It is not proper to regard a word, a clause or a sentence occurring in a judgment of the Supreme Court,

> divorced from its context, as containing a full exposition of the law on a question when the question did not even fall to be answered in that judgment."

Section 90 of the Income Tax Act, which deals with agreement with foreign countries or specified territories reads as under:

90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India, -

(a) for the granting of relief in respect of-

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income–tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom

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such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation 1.- For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Explanation 2.- For the purposes of this section, "specified territory" means any area outside India which may be notified as such by the Central Government. "

Section 245S of the Act which deals with Applicability of Advance ruling reads as under:-

"245S.(1) The advance ruling pronounced by the Authority under section 245R shall be binding only-

(a) on the applicant who had sought it;

(b) in respect of the transaction in relation to which the ruling had been sought; and

(c) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.

(2) The advance ruling referred to in sub-section (1) shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced. "

15. Section 9 of the Act deals with income deemed to accrue or arise in India, which reads as under:

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

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Section 9(1)(vi) of the Act reads as under:

(vi) income by way of royalty payable by-

(a) the Government; or

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

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

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or

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specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April 197, and the agreement is approved by the Central Government:

Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any right (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.

Explanation (2) reads as under:

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

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

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

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

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

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

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

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

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Not Approved

The definition of the term 'royalty' is similar in all the DTAA agreements entered into with foreign countries and the same reads as under:

> "Payment 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 hereof."

16. The Hon'ble Supreme Court in UNION OF INDIA Vs AZADI BACHAVO ANDOLAN (263 ITR 705) has laid down that provisions of DTAA prevails over the provisions of the Act if the provisions of DTAA is more beneficial to the assessee. It is clear on perusal of the definition of 'royalty' under the Act and the DTAA as culled out above, the definition of 'royalty' is restrictive in DTAA whereas, the definition of 'royalty' under the Act is broader in its content . Therefore, the definition of 'royalty' in DTAA is more

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beneficial to the assessee as according to the assessee, payment is not royalty and therefore, the royalty in the restricted meaning under DTAA is more beneficial to the assessee and hence, we have to find out as to whether the payment made by the respondent would amount to royalty under the clause in DTAA. Even otherwise, it is clear that if the payment is held to be royalty within the restricted meaning given to the term in the DTAA, naturally, it would also to be covered within the term 'royalty' in the broader meaning to the term 'royalty' under the Act.

17. It is clear from the scrutiny of the material on record and the contentions of the parties viz., revenue and the respective respondent in these cases that the fact that payments have been made by the respondent herein to non-resident for having imported shrink wrapped software / off-the-shelf software is not disputed. There is also no dispute that no tax was deducted at source by the respondent under Section 195(1) of the Act in respect of such payments on the ground that the same were made for the purpose of purchase

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of shrink wrapped software / off-the-shelf software. It is contended by the respondent that since there is no permanent establishment of the non-resident in India, the said payments have to be treated as income from business and is not taxable under the Income Tax Act in India and consequently, there is no obligation on the part of the respondent to deduct the advance tax under Section 195 of the Act and also consequential proceedings would not be attracted. Therefore, the dispute between the revenue and the respondent in these cases is whether payments made by the respondent to the non-resident would constitute `royalty` or `Income from Business` and if it is to be treated as `Income from Business`, whether the non-resident is required to have a permanent establishment in India. Further, in the absence of any permanent establishment of the non-resident in India, is there no obligation on the part of the payee, the respondent herein to deduct tax at source under Section 195 of the Act. Therefore, the fact that the payments made by the payee, the respondent herein to the non-resident would constitute income of the non-resident is indisputable. However, the dispute is as to whether such income in the hands of the non-resident is to be treated as sale and income from business covered under Article 7 of the DTAA with respective countries or whether the payments would amount to royalty in the hands of the non-resident, for which no permanent establishment is required for making payment in India. There is also no dispute that if the payments made by the respondent are held to be royalty and not 'Income from Business', there is an obligation on the part of the payee, the respondent herein to deduct the tax at source and in default, the respondent herein would be considered as a default assessee. Once there is an obligation to deduct tax at source under Section 195 of the Act, which imposes a statutory right on any person responsible for paying to a non-resident, any interest (not being interest on securities) or any other sum (not being dividend) chargeable under the provisions of the Act, to deduct income-tax at the rates in force unless he is liable to pay income-tax thereon as an agent. Payment to non-residents by way of royalty and payment for technical services rendered in India are common

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examples of sums chargeable under the provisions of the Act to which the aforestated requirement of TDS applies. The tax so collected and deducted is required to be paid to the credit of Central Government in terms of Section 200 of the Act read with rule 30 of the Income Tax Rules, 1962. Failure to deduct tax or failure to pay tax would also render a person liable to penalty under Section 201 read with Section 221 of the Act. In addition, he would also be liable under Section 201(1A) to pay simple interest at 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. Therefore, if the amount is held to be royalty, the other consequences as referred to above would follow.

18. In view of the substantial question of law framed by the Hon'ble Supreme Court to be adjudicated in these appeals and the above said contentions of the learned counsel appearing for the parties, the only contention which is required to be considered is as to whether the payments made by the respondent – payee to a non-resident includes

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the amount chargeable to tax under the Act and if so, is there an obligation on the part of the respondent to make a deduction under Section 195(1) of the Act or as to whether the said payments would only amount to sale of the shrink wrapped software or off-the-shelf software and would constitute income from business in the office of the non-resident and in the absence of any permanent establishment of the non-resident in India, the same would not impose any obligation on the part of the payee, the respondent herein to deduct tax at source under Section 195 of the Act and consequently, they cannot be treated as default assessees as referred to above.

19. In view of the above said observations and the contents of the DTAA with different Countries, wherein definition of `royalty` is common in all the agreements, it is necessary to reproduce the said definition of `royalty` in clause 12 of the DTAA, which reads as under:-

"**Article 12 of DTAA WITH USA:**

**Article 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.

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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

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> 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 above said 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 `literary work` as under:-

> "literary work" includes computer programmes, tables and compilations including computer [databases];

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Therefore, `computer software` has been recognized as copy right work in India also.

20. Having regard to the above said definition of `royalty`, we have to consider the contents of software licence agreement entered into by non-resident with Samsung Electronics and also 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) (progam(s) on the terms and conditions enumerated in the agreement. It is further averred that the customer – Samsung Electronics shall protect confidential information and shall not remove any copyright, confidentiality or other proprietary 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 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 agreement, 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 licenses set forth in Exhibit A to the agreement only to End Users pursuant to a valid Actuate shrinkwrap or other Actuate license 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. Distributor shall have no rights to the Software other than the rights expressly set forth in the agreement. Distributor shall not modify or copy any part of the Software or Documentation. Distributor may not use subdistributors 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, trademark, trade secret and other intellectual property rights pertaining thereto, shall be and remain the sole property of Actuate. 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-resident, 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.

21. It is further contended by the learned senior counsel appearing for the respondents` that in view of the fact that what is supplied by the non-resident to the respondent in India is only a shrink wrapped software / off-the-shelf software, which is not customised to suit the needs of the respondent, the said software is to be treated as goods and there is sale of the software and copy of the software. Therefore, the question of paying any royalty would not arise. In support of the said contention, the learned senior counsel appearing for the respondents` has strongly relied upon the decision of the Hon`ble Supreme Court in TATA CONSULTANCY SERVICES Vs. STATE OF ANDHRA PRADESH (2004 ITR (Vol. 271) 401) (hereinafter referred to as `the TCS`s case), wherein the Hon`ble Supreme Court was considering the question as to whether the canned software sold by the appellants can be termed to be "goods" and as such assessable to sales tax under the Andhra Pradesh

General Sales Tax Act, 1957. Having regard to the broad definition of `goods` under Section 2(h) of the said Act and also the provisions of Article 366(12) of the Constitution of India, the Hon`ble Supreme Court was pleased to answer the said question for determination by holding that once the 'information' or 'knowledge' is transformed into physical existence and recorded in physical form, it is corporeal property. The physical recording of the software is not an incorporeal right to be comprehended and accordingly, held that the software marketed by the appellants therein indisputably was canned software and thus, sale of the same would attract the provisions of the Andhra Pradesh General Sales Tax Act, 1957.

22. The question as to whether the payment made for import of software or supply of software by the non-resident Companies was royalty or not was not at all in issue in TCS`s case and the question was whether canned software sold by the appellants therein amounted to sale of goods under the Andhra Pradesh General Sales Tax Act. Further,

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the issue of transfer of right to use the goods as per the expanded definition of `sale` did not come up for consideration in that case. On the other hand, the issue in the present case is as to whether the payment would amount to `royalty` within the meaning of Income Tax Act and DTTA. In the said TCS`s case, it has been held that copyright in computer program may remain with the originator of the program, but, the moment copies are made and marketed, it becomes goods, which are susceptible to tax. The contention of the assessee that the consideration received by the non-resident supplier towards the software products would amount to `royalty` within the meaning of DTAA with respective country was not at all considered in the said case. Therefore, the said decision in TCS`s case is not helpful to the respondents` in the present cases. It is well settled that the intent of the legislature in imposing Sales Tax and Income Tax are entirely different as Income Tax is a direct tax and Sales Tax is an Indirect Tax and wherefore, mere finding that the computer software would be included within the term `Sales Tax` would not preclude this Court from holding that the said payments made by the respondents` to the non-resident Company in the present cases would amount to `royalty` unless the respondents are able to prove that the said payment is for the sale of computer software, wherein the income would be from the business and in the absence of any permanent establishment of the non-resident supplier, there is no obligation on the part of the payee to make deduction under Section 195(1) of the Act.

23. It is well settled that in the absence of any definition of ` copyright` in the Income Tax Act or DTAA with the respective Countries, in view of clause 3 of the DTAA, reference is to be made to the respective law regarding definition of `Copyright`, namely, Copyright Act, 1957, in India, wherein it is clearly stated that "literary work" includes computer programmes, tables and compilations including computer [databases]. Section 16 of the Copyright Act, 1957 states that no person shall be entitled to copyright or any similar right in any work, whether published or unpublished, otherwise than under and in accordance with

the provisions of the said Act or of any other law for the time being in force, but nothing in this section shall be construed as abrogating any right or jurisdiction to restrain a breach of trust or confidence. Section 14 of the said Act dealing with meaning of `Copyright` reads as follows:-

> "14. **Meaning of Copyright**. – For the purposes of this Act, "copyright" means the exclusive right subject to the provisions of this Act, to do or 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 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;

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(iv) to make any cinematograph film or sound recording in respect of the work;

(v) to make any translation of the work;

(vi) to make any adaptation of the work;

(vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

(b) in the case of a computer programme,-

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

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

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

(c) in the case of an artistic work,-

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(i) to reproduce the work in any material form including depiction in three dimensions of a two-dimensional work or in two dimensions of a three-dimensional work;

(ii) to communicate the work to the public;

(iii) to issue copies of the work to the public not being copies already in circulation;

(iv) to include the work in any cinematograph film;

(v) to make any adaptation of the work;

(vi) to do in relation to an adaptation of the work any of the acts specified in relation to the work in sub-clauses (i) to (iv);

(d) in the case of a cinematograph film,-

(i) to make a copy of the film, including a photograph of any image forming part thereof;

(ii) to sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions;

(iii) to communicate the film to the public;

(e) in the case of a sound recording,-

(i) to make any other sound recording embodying it;

(ii) to sell or give on hire, on offer for sale or hire, any copy of the sound recording regardless of whether such copy has been sold or given on hire on earlier occasions;

(iii) to communicate the sound recording to the public.

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

It may also be noted that under Section 51 of the Act dealing with "When Copyright infringed" states that Copyright in a work shall be deemed to be infringed - when any person, without a licence granted by the owner of the Copyright or the Registrar of Copyrights under the Act or in contravention of the conditions of a licence so granted or of any condition imposed by a competent authority under the Act does anything, the exclusive right to do which is by the Act conferred upon the owner of the Copyright. Section 52 of the Act dealing with Certain acts not to be infringement of copyright states that the following acts shall not constitute an infringement of copyright, namely-

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(aa) the making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copy -

(i) in order to utilise the computer programme for the purpose for which it was supplied; or

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

24. It is clear from the above said provisions of the Copyright Act that the right to copyright work would also constitute exclusive right of the copyright holder and any violation of the said right would amount to infringement under Section 51 of the Act. However, if such copying of computer program is done by a lawful possessor of a copy of such computer programme, the same would not constitute

infringement of copyright and wherefore, but for the licence granted in these cases to the respondent to make copy of the software contained in shrink-wrapped / off-the-shelf software into the hard disk of the designated computer and to take a copy for backup purposes, the end user has no other right and the said taking backup would have constituted an infringement, but, for the licence. Therefore, licence is granted for taking copy of the software and to store it in the hard disk and to take a back up copy and right to make a copy itself is a part of the copyright. Therefore, when licence to make use of the software by making copy of the same and to store it in the hard disk of the designated computer and to take back up copy of the software, it is clear that what is transferred is right to use the software, an exclusive right, which the owner of the copyright i.e., the respondent -- supplier owns and what is transferred is only right to use copy of the software for the internal business as per the terms and conditions of the agreement. The decision of the Delhi High Court in COMMISSIONER OF INCOME TAX DELHI-V Vs. M/s. DYNAMIC VERITCAL SOFTWARE

INDIA PVT. LTD in ITA No.1692/2010 DATED 22.02.2011 relied upon by Sri Aravind Dattar, learned senior counsel appearing for the respondents` in some of the cases in support of his contention that by no stretch of imagination, payment made by the respondents to the non-resident suppliers can be treated as `royalty` is not helpful to the respondents in the present cases as in the said case, Delhi High Court was considering the provisions of Sections 40(a)(i) of the Act and the order of the High Court reads as follows:-

> "What is found, as a matter of fact, is that the assessee has been purchasing the software from Microsoft and sold it further in Indian market. By no stretch of imagination, it would be termed as royalty."

Therefore, the contention of the learned senior counsel appearing for the respondents` that there is no transfer of any part of copyright or copyright under the impugned agreements or licenses cannot be accepted. Accordingly, we hold that right to make a copy of the software and use it for internal business by making copy of the same and storing the same in the hard disk of the designated computer and taking back up copy would itself amount to copyright work under Section 14 (1) of the Act and licence is granted to use the software by making copies, which work, but for the licence granted would have constituted infringement of copyright and licencee is in possession of the legal copy of the software under the licence. Therefore, the contention of the learned senior counsel appearing for the respondents' that there is no transfer of any part of copyright or copyright and transaction only involves sale of copy of the copyright software cannot be accepted. It is also to be noted that what is supplied is the copy of the software of which the respondent – supplier continues to be the owner of the copyright and what is granted under the licence is only right to copy the software as per the terms of the agreement, which, but for the licence would amount to infringement of copyright and in view of the licence granted, the same would not amount to infringement under Section 52 of the Copyright Act as referred to above. Therefore, the amount paid to the non-resident supplier towards supply of shrink-

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wrapped software or off-the-shelf software is not the price of the C.D. alone nor software alone nor the price of licence granted. This is a combination of all and in substance, unless licence is granted permitting the end user to copy and download the software, the dumb C.D. containing the software would not in any way be helpful to the end user as software would become operative only if it is downloaded to the hardware of the designated computer as per the terms and conditions of the agreement and that makes the difference between the computer software and copyright in respect of books or prerecorded music software as book and prerecorded music C.D. can be used once they are purchased, but so far as software stored in dumb C.D. is concerned, the transfer of dumb C.D. by itself would not confer any right upon the end user and the purpose of the C.D. is only to enable the end user to take a copy of the software and to store it in the hard disk of the designated computer if licence is granted in that behalf and in the absence of licence, the same would amount to infringement of copyright, which is exclusively owned by non-resident suppliers, who would continue to be the proprietor of copyright. Therefore, there is no similarity between the transaction of purchase of the book or prerecorded music C.D. or the C.D. containing software and in view of the same, the Legislature in its wisdom, has treated the literary work like books and other articles separately from `computer software` within the meaning of the `Copyright` as referred to above under Section 14 of the Copyright Act.

25. It is also clear from the above said analysis of the DTAA, Income Tax Act, Copyright Act that the payment would constitute `royalty` within the meaning of Article 12(3) of the DTAA and even as per the provisions of 9(1)(vi) of the Act as the definition of `royalty` under clause 9(1)(vi) of the Act is broader than the definition of `royalty` under the DTAA as the right that is transferred in the present case is 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 as per clause (iv) of explanation 2 to Section 9(1)(vi) of the Act. In any view of the matter, in view of the provisions of Section 90 of the Act, agreements with foreign countries DTAA would override the provisions of the Act. Once it is held that payment made by the respondents ` to the non-resident Companies would amount to `royalty` within the meaning of Article 12 of the DTAA with the respective country, it is clear that the payment made by the respondents` to the non-resident supplier would amount to royalty. In view of the said finding, it is clear that there is obligation on the part of the respondents` to deduct tax at source under Section 195 of the Act and consequences would follow as held by the Hon`ble Supreme Court while remanding these appeals to this Court. Accordingly, we answer the substantial question of law in favour of the revenue and against the assessee by holding that on facts and circumstances of the case, the ITAT was not justified in holding that the amount(s) paid by the respondent(s) to the foreign software Suppliers was not 'royalty' and that the same did not give rise to any 'income' taxable in India and wherefore, the respondent(s) were not liable to deduct any tax at source and pass the following Order:-

All the appeals are allowed. The order passed by the Income Tax Appellate Tribunal, Bangalore Bench 'A' impugned in these appeals is set aside and the order passed by the Commissioner of Income Tax (Appeals) confirming the order passed by the Assessing Officer (TDS)-I is restored.

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