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

BEFORE SHRI P.M.JAGTAP (A.M) & SHRI N.V.VASUDEVAN(J.M)

ITA NO.3219/MUM/2010(A.Y. 2006-07)

The DDIT (IT)2(1), R.No.120, 1st Floor, Scindia House, Bellard Estate, N.M.Road, Mumbai – 038. (Appellant)	Vs.	M/s. Solid Works Corporation, C/o. Pricewaterhouse Coopers (P) Ltd., 252, Veer Sawarkar Marg, Shivaji Park, Dadar, Mumbai – 400 028. PAN:AAFCS 8787E (Respondent)

Appellant by	:	Shri Jitendra Yadav / Smt. Malathi Sridharan
Respondent by	:	S/Shri Kanchan Kaushal/ Dhanesh Bafna/ Aliasger Rampurawala

Date of hearing	:	05/01/2012
Date of pronouncement	:	08/01/2012

ORDER

PER N.V.VASUDEVAN, J.M,

This is an appeal by the Revenue against the order dt.31.1.2010 of CIT(A)-II, Mumbai, relating to AY 06-07. The grounds of appeal raised by the Revenue read as follows:

> "1. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that the assessing officer has wrongly held that the payment received by the assessee from resellers on sale of shrink wrap software is in the nature of 'Royalty' which is liable for taxation in India within the meaning of Article 12(3) of the Indo-US DTAA.
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> 2. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that since the taxes are to be deducted at

source, the , the assessee is not liable to pay interest under section 234B of the Income-tax Act.

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

3. The issue raised by the Revenue in this appeal is identical to the issue raised by it in AY 03-04 and 05-06 before the Tribunal in ITA No.3095/mum/07 and ITA No.5097/mum/08 respectively. This Tribunal on identical facts has already taken a view that that the sums received by the Assessee in both the aforesaid A.Y.s for supply of software is not in the nature of royalty within the meaning of Article 12(3) of the DTAA between India and USA and was in the nature of business income and since the Assessee did not have a Permanent Establishment (PE) in India the receipts are not taxable in India. The operative part of the order of the Tribunal in ITA No.3095/Mum/07 for AY 03-04 reads as follows:

> 3. The assessee is a company incorporated in the USA and a tax resident of USA. The assessee filed tax resident certificate before the Assessing Officer and is therefore entitled to the benefit of the Double Taxation Avoidance Agreement between India and USA (DTAA). The assessee develops and markets 3D mechanical design solution in various countries. The shrink-wrap application software developed and sold by assessee is called 'Solidworks 2003' which is used for 3D modeling. The software creates 3D models either from scratch or from existing 2D data. The designed data prepared by Solidworks 2003 software provides data which is 100% editable. The software is provided in a packed form to the customers in India alongwith and pursuant to an end user license agreement (EULA). The agreement is not physically signed but built in as part of the installation process. The license agreement pops up on computer screen and must be accepted by the user before the user can operate the software. The software provided to the user is a single user license whereby the software can be loaded in one computer or can be used many times (called multiple user license) which can be loaded on several computers. Solidwork owns and will retain all copyright, trade mark, trade secrete and other proprietary rights. The end user is not

permitted to make any modification or make works derivative of the software and user is not entitle to reverse engineer, decompile, disassemble or otherwise discover the source code of the software.

4. For the purposes of marketing the shrink wrap software, the assessee had entered into agreement with various distributors/resellers in India. Copy of a software distribution agreement was filed before the Assessing Officer. All distribution agreements are identical. As per the software distribution agreement, the distributor gets right to market distribute and support the product. However, distributor does not get any exclusive distributor rights. He also does not get any right to disassemble, decompile or reverse engineer the software. Copyright over software remain with the assessee. On these facts, it was claimed by the assessee before the Assessing Officer that the software being sold by the assessee was a shrink wrap software being sold to customers for their personal use without transfer of any copyright, trade mark, or patent etc. In view of this payment received for supply of software was not royalty and was only business income. The assessee did not have a permanent establishment (PE) in India and therefore business income is not taxable as per Article-7 of the DTAA.

5. The Assessing Officer did not agree with the plea of the assessee. He held that the payment received by the assessee was in the nature of royalty and he accordingly brought the same to tax. On appeal by the assessee, learned CIT(A) held that the payment in question was not in the nature of royalty and was payment for purchase of copyrighted article. Addition made by the Assessing Officer was deleted by the learned CIT(A) giving rise to Ground No. 1&2 of the revenue before the Tribunal.

6. We have heard the rival submissions. The sample copy of the software distribution agreement filed before the lower authority shows that under section 6, thereof, the distributor has to obtain orders for the product and was free to fix price of the product. The assessee had a right to accept or reject the request of the distributor for supply. The distributor was not authorized directly or indirectly to entered into any written or oral contract on behalf of the assessee. More importantly, distributor cannot tamper with or remove from the original packaging and all product shall be distributed by the distributor in unopened packaging in which such products were received from the assessee. The Distributor does not have any right to make further copies of the products. Under section 3 of the agreement, which grants license for

use of the product by the ultimate consumer clearly provides that distributor cannot disassemble, decompile or in any way attempt to reverse engineer any of the product or to modify or make works derived from the products. It also provides that license to use cannot be construed as a right to make copies of the product. When the ultimate consumer uses the product he has to subscribe the end user license agreement (EULA). This only provides facility to ultimate consumer to install software on his computer and use it personally without allowing any right to the consumer of disassemble, reverse engineer, decompile the software. Customer is also not entitled to sell, license, sub-license, transfer, assign, lease or rent the software. It is thus clear neither the distributor nor end user has any right over the copyright of the software.

7. The Hon'ble Supreme Court in the case of Tata Consultancy Services Pvt. Ltd. Vs. State of Andhra Pradesh (2004) 271 ITR 401 has held as follows :-

> "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 sale 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 'good'. We see no different 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 on 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."

8. Thus computer software when it is put on to a media and sold has become goods like any other audio cassette or painting on canvas or a book. It is ceases to be transfer of intellectual property right. In fact, Bangalore Bench of the Tribunal in the case of Lucent

Technologies Hindustan Ltd. Vs. ITO, 92 ITD 366 (Bang) has also taken the view that in such a situation there is no acquisition of any right in software. Definition of 'royalty' is given in section (9)(1) Explanation (2) of the Act and the definition of Royalty in Article 12(3) of the Indo-US DTAA shows that definition of royalty under DTAA is more restrictive than what is provided in section (9)(1) of the Act. Under the definition as contained in DTAA, there should be a transfer of copyright. Sale of software by the assessee to the distributor or end user does not involve any transfer of copyright either in part or in whole; therefore consideration paid by the distributor cannot be said to be a payment for right of use copyright or transfer of use of copyright. It has been uniformly held in several decisions of the ITAT that sale of shrink-wrap software does not involve receipt of consideration, which can be said to be royalty. Decisions in this regard are as follows :-

- Samsung Electronics Co. Ltd. Vs. ITO, 93 TTJ 658
- Motorola Incorporation, 270 ITR (AT) 62
- Sonata Information Technologies Ltd., ITA No. 1561 to 1580/Bang/2004 dated 31.1.2006.

9. Computer programme cannot also be treated as patent and invention. Computer programne cannot said to be an invention and therefore cannot be said to be covered by the Patient Act. Computer software cannot also be treated as process. End user of the software in the case of shrink-wrap software does not have any access to source code. He has only right to use the software for his personal or business use. For all the above reasons, we are of the view that learned CIT(A) was right in concluding that payment received by the assessee was not in the nature of royalty and cannot therefore be brought to tax. We uphold the order of learned CIT(A) on this issue and dismiss Ground No. 1&2 raised by the revenue.

4. Despite the aforesaid orders on identical facts, the learned D.R. however submitted that the decision rendered by the Tribunal in the earlier years requires reconsideration and made the following submissions. The Assessee distributes its software to the end user through its distributors and sub distributors in India. The Distribution agreement contains terms and conditions subject to which the software distributor is to distribute the

software to the end user. The distribution agreement also contains an end users licence agreement (EULA). The Learned DR drew out attention to the EULA and submitted that the end user is granted only a license to use the software. He also pointed out that the EULA in clause 1-C provides for a security mechanism being embedded in the software to ensure that the terms of the license are not violated. His submission was that the Assessee has complete control over the use of the software and therefore to say that the software is a copyrighted article and not use of software is not correct. His submission was that even the distributor gets only a license and therefore there can be no sale of a copyrighted article as has been held in the earlier assessment years. The submissions of the learned D.R. are principally based on the decision of the Hon'ble Karnataka High Court in the case of CIT Vs. Samsung Electronics co. Ltd. ITA No.2808 of 2005 dated 15.10.2011, a copy of which has been filed before us. The Hon'ble Karnataka High Court was dealing with a case where the question was as to whether the amounts paid to the foreign software suppliers were royalty. The Hon'ble Court after considering the provisions of Sec.14 of the Copyright Act, 1957, definition of "Royalty" under Double Taxation Avoidance Agreement (DTAA), terms of use of shrink wrap software by the end user, distributor and sub-distributor, held as follows:

> "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 1granted 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 respondent 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)(1) 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 el 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 copy right 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 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 CD can be used once they are purchased, but so far as software stored in dumb CD is concerned, the transfer of dumb C.D. by itself would not confer any right upon the end user and the purpose of the CD 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 prercorded 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(l)(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:
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>> "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."

5. The learned counsel for the Assessee relied on the decision of the Hon'ble Delhi High Court in the case of Director of Income Tax Vs. Ericsson A.B., New Delhi ITA No.504/2007 dated 23.12.2007. The Hon'ble Delhi High Court was dealing with a question as to whether the Tribunal was justified in holding that the consideration for supply of software was not a payment by way of royalty, and hence was not assessable both u/s.9(1)(vi) of the Act and the relevant clause of DTAA with Sweden. The facts of the aforesaid case were that the assessee company was incorporated in Sweden and was one of the leading suppliers of telecommunication equipment comprising of both, hardware and software. The assessee company had entered into agreements with ten cellular operators in India for supply of hardware and software. The Assessing Officer was of the view that the income of the assessee was taxable in India, both, under the Income-tax Act, 1961 as well as under the treaty between India and Sweden. He held that it was business income and Assessee had a PE in India. The CIT(A) held that the receipts in respect of license to use software which is part of the hardware alone could be taxed in

India as royalty. The Assessee argued before Tribunal that the payment made by the assessee for the use of software in the equipment does not amount to royalty. The Tribunal in the aforesaid context examined the issue as to whether the payment is for a 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. The Tribunal after referring to definition of Royalty under the Act and the definition copyright under the Copyright Act, 1957 held that what was sold by the non resident was a copyrighted article and payment to the non resident was not for copyright. On further appeal by the Revenue, the Hon'ble Delhi High Court examined the issue which we have set out earlier. The Hon'ble Delhi High Court held that income did not accrue to the non-resident by virtue of a business connection in India and therefore the question of the Non resident having a permanent establishment in India did not arise for consideration at all. On the issue whether the payment to the non resident was of the nature of royalty which could be brought to tax in India, the Hon'ble Delhi High Court held as follows:

> "WHETHER THE INCOME FROM THE SUPPLY CONTRACT CAN BE TREATED AS 'ROYALTY' UNDER SECTION 9(1)(vi) OF THE ACT:
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> 50. Section 9 (1) (i) of the Act which deals with the taxability of „royalty income‟ reads as under:-
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> "Section 9 .INCOME DEEMED TO ACCRUE OR ARISE IN INDIA.
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> (1) The following incomes shall be deemed to accrue or arise in India :-
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> (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"

51. The submission of Mr. Prasaran, learned ASG was that software part of the equipment supply would attract royalty as copy right of the said software programme still vests with the assessee. Therefore, payments made for the licence to use the software programme give rise to "royalty" for the purposes of both the Income-Tax Act as well as DTAA entered into between Sweden and India. Referring to Explanation-II (v) to Section ((1) (vi) of the Act as well as Article 13, para-3 of DTAA, it was argued that for the purposes of Income-Tax law, royalty is essentially a payment received as consideration for the use or right to use a particular integral property right, whether partially or entirely.

52. We find that the Tribunal has held that there was no payment towards any royalty and this conclusion is based on the following reasoning:-

(i) Payment made by the cellular operator cannot be characterized as royalty either under the Income Tax Act or under the DTAA.

(ii) The operator has not been given any of the seven rights under S.14 (a) (i) to (vii) of the Copyright Act, 1957 and, therefore what is transferred is not a copyright but actually a copyrighted article

(iii) The cellular operator cannot commercially exploit the software and therefore a copyright is not transferred.

(iv) Further, the parties to the agreement have not agreed upon a separate price for the software and therefore it is not open for the income tax authorities to split the same and consider part of the payment for software to be royalty

(v) The bill of entry for importing of goods shows that the price has been separately mentioned for software and that this was only for the purposes of customs. There is no evidence to show that the assessee was a party to the fixation of value for the customs duty purposes

(vi) The software provided under the contract is goods and therefore no royalty can be said to be paid for it.

53. Mr. Prasaran, countered the aforesaid reasoning arguing that Clause 20 of the Supply Contract uses the term „licence" and the same term is used in the context of software throughout the three Agreements, indicating that it is not an outright sale of goods, or a full transfer of rights from the assessee to the Indian company. He also submitted that the software is a computer programme, which is treated differently from a book, not only in the Copyright Act, 1957 but also the Income Tax Act itself. His submission was that Section 52(1)(aa) of the Copyright Act only deems that certain acts will not to amount to infringement in the light of various concerns, where otherwise such acts would amount to infringement under Section 51 of the Copyright Act. The provision cannot by itself be used to hold that no right exists in the first place, since the scope of the right has to be understood only from the provisions of Section 14 of the Copyright Act, 1957. He also argued that the ITAT has misinterpreted the provisions of the DTAA, specifically Article 13, para 3 of the DTAA (Article 12, para 3 of the Model Convention) which defines royalties to mean "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work". The ITAT, it was submitted, has not appreciated that the royalty is for the use or right to use any copyright. According to him, since title of the software continued to vest with the assessee as provided in clause 20.2 of the Supply Agreement and the assessee was free to grant non-exclusive licenses to other parties, it follow that there was no full time transfer of copyright but it was only a case of right to use the software, and thus payment for use of software is to be treated as royalty. He further argued that reference to OECD Commentary was not apposite as it could not be used to interpret the scope of the relevant provisions of DTAA.

54. It is difficult to accept the aforesaid submissions in the facts of the present case. We have already held above that the assessee did not have any business connection in India. We have also held that the supply of equipment in question was in the nature of supply of goods. Therefore, this issue is to be examined keeping in view these findings. Moreover, another finding of fact is recorded by the Tribunal that the Cellular Operator did not acquire any of the copyrights referred to in Section 14 (b) of the Copyright Act,1957.

55. Once we proceed on the basis of aforesaid factual findings, it is difficult to hold that payment made to the assessee was in the nature of royalty either under the Income-Tax Act or under the DTAA. We have to keep in mind what was sold by the assessee to the Indian customers was a GSM which consisted both of the hardware as well as

the software, therefore, the Tribunal is right in holding that it was not permissible for the Revenue to assess the same under two different articles. The software that was loaded on the hardware did not have any independent existence. The software supply is an integral part of the GSM mobile telephone system and is used by the cellular operator for providing the cellular services to its customers. There could not be any independent use of such software. The software is embodied in the system and the revenue accepts that it could not be used independently. This software merely facilitates the functioning of the equipment and is an integral part thereof. On these facts, it would be useful to refer to the judgment of the Supreme Court in TATA Consultancy Services Vs. State of Andhra Pradesh, 271 ITR 401, wherein the Apex Court held that software which is incorporated on a media would be goods and, therefore, liable to sales tax. Following discussion in this behalf is required to be noted:-

> "In our view, the term "goods" as used in Article 366(12) of the Constitution of India and as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. (supra). 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 on 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 sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction,

consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc. The software programmes have all these attributes."

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"In Advent Systems Ltd. v. Unisys Corpn, 925 F. 2d 670 (3rd Cir. 1991), relied on by Mr. Sorabjee, the court was concerned with interpretation of uniform civil code which "applied to transactions in goods". The goods therein were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". It was held :

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.

That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

56. A fortiorari when the assessee supplies the software which is incorporated on a CD, it has supplied tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty.

57. It is also to be borne in mind that the supply contract cannot be separated into two viz. hardware and software. We would like to refer the judgment of Supreme Court in CIT Vs. Sundwiger EMFG Co., 266 ITR 110 wherein it was held:

"A plain and cumulative reading of the terms and conditions of the contract entered into between the principal to principal i.e., foreign company and Midhani i.e., preamble of the contract, Part-I and II of the contract and also the separate agreement, as referred to above, would clearly show that it was one and the same transaction. One cannot be read in isolation of the other. The services rendered by the experts and the payments made towards the same was part and parcel of the sale consideration and the same cannot be severed and treated as a business income of the non-resident company for the services rendered by them in erection of the machinery in Midhani unit at Hyderabad.

Therefore, the contention of the Revenue that as the amounts reimbursed by Midhani under a separate contract for the technical services rendered by a non-resident company, it must be deemed that there was a "business connection", and it attracts the provisions of Section 9(1)(vii) of the Income Tax Act cannot be accepted and the judgments relied upon by the Revenue are the cases where there was a separate agreement for the purpose of technical services to be rendered by a foreign company, which is not connected for the fulfillment of the main contract entered intoprincipal to principal. This is not one such case and thus the contention of the Revenue cannot be accepted in the circumstances and nature of the terms of the contract of this case."

58. No doubt, in an annexure to the Supply Contract the lump sum price is bifurcated in two components, viz., the consideration for the supply of the equipment and for the supply of the software. However, it was argued by the learned counsel for the assessee that this separate specification of the hardware/software supply was necessary because of the differential customs duty payable.

59. Be as it may, in order to qualify as royalty payment, within the meaning of Section 9(1) (vi) and particularly clause (v) of Explanation-II thereto, it is necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copy right of a literary, artistic or scientific work. Section 2 (o) of the Copyright Act makes it clear that a computer programme is to be regarded as a„literary work". Thus, in order to treat the consideration paid by the cellular operator as royalty, it is to be established that the cellular operator, by making such payment, obtains all or any of the copyright rights of such literary work. In the presence case, this has not been established. It is not even the case of the Revenue that any right contemplated under Section 14 of the Copyright Act,1957 stood vested in this cellular operator as a consequence of Article 20 of the Supply

> Contract. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article".
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> 60. Mr. Dastur is right in this submission which is based on thecommentary on the OECD Model Convention. Such a distinction has been accepted in a recent ruling of the Authority for Advance Ruling (AAR) in Dassault Systems KK 229 CTR 125. We also find force in the submission of Mr. Dastur that even assuming the payment made by the cellular operator is regarded as a payment by way of royalty as definedin Explanation 2 below Section 9 (1) (vi), nevertheless, it can never be regarded as royalty within the meaning of the said term in article 13, para 3 of the DTAA. This is so because the definition in the DTAA is narrower than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case.
>
> 61. We thus hold that payment received by the assessee was towards the title and GSM system of which software was an inseparable parts incapable of independent use and it was a contract for supply of goods. Therefore, no part of the payment therefore can be classified as payment towards royalty."

6. Before us the learned D.R. as well as the learned counsel for the Assessee referred to several decisions of the Tribunal rendered on identical issue. These decisions are not being considered as the two decisions of the Hon'ble High court of Karnataka and Hon'ble High Court of Delhi were rendered after those decisions rendered by the Tribunal and these two decisions are the decisions of High Court available as of now on the issue. Both the decisions have taken note of the terms of the agreement subject to which software was to be used by the customer.

7. It was the submission of the learned counsel for the Assessee that where two views are available on an issue one favourable to the Assessee and the one against the Assessee, the view which is favourable to the Assessee and does not support levy of tax on the Assessee should be

preferred. The learned D.R. on the other hand submitted that the decision of the Hon'ble Delhi High Court was rendered in the context of sale of equipment in which software was embedded and not a case of shrink wrap software as such and therefore that decision should be applied to a case where sale of shrink wrap software is involved. Alterntively it was submitted by him that the concession that where two views are available on an issue one favourable to the Assessee and the one against the Assessee, the view which is favourable to the Assessee and does not support levy of tax on the Assessee should be preferred, should not be applied to non-resident assesses.

8. On the argument of the learned D.R. that where two views are available on an issue one favourable to the Assessee should be preferred, should not be applied to non-resident assesses, we are of the view the same cannot be accepted in view of Article 24 of the DTAA between India and USA which provides for Non-discrimination. Article 24(1) lays down that Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of article 1, also apply to persons who are not residents of one or both of the Contracting States. Therefore where two views are available on an issue one favourable to the Assessee and the one against the Assessee, the view which is favourable to the Assessee and does not support levy of tax on the Assessee should be preferred, should be applied to non-resident assesse in this case.

9. On the other submission of the learned D.R. that the decision rendered by the Hon'ble Delhi High Court was in respect of use of software

embedded in an equipment supplied and therefore the same should not be applied to the case of shrink wrap software, we are of the view that the Hon'ble Delhi High Court after referring to the decision of the Hon'ble Supreme Court in the case of Tata Consultancy Services (supra) went on to observe at para-56 of its judgment that when software is incorporated in a CD it becomes a tangible property and the payment made for acquiring the same is not a payment by way of royalty. In para-60 of its judgment, the Hon'ble Delhi High Court has approved the ruling of the Authority for Advance Ruling (AAR) in the case of Dassault Systems KK 322 ITR 125 (AAR). The facts giving rise to the ruling of the AAR were that the applicant, a Japanese company, engaged in the business of providing "Products lifecycle management" software solutions, applications and services, marketed licensed software products mostly through a distribution channel comprising value added resellers (VAR) who were independent third party resellers. To authorize a VAR to act as a reseller the applicant entered into a general VAR agreement. The terms of the agreement explicitly provided for the appointment of reseller/distributor of product on a non-exclusive basis for making the product available to the end-user within the territory for his internal use. The product was sold to the VAR for a consideration based on the standard list price less discount ; and the VAR in turn would sell the product to the end-users at a price independently determined by the VAR. The end-user would enter into the end-user licence agreement with the applicant and the VAR for the product supplied. The reseller did not hold any inventory of the software in India. The VAR was free to negotiate the price with the customer but the VAR paid to the applicant the standard price in force less agreed discount. The reseller (VAR) would get the order from the end-user and place a back-to-back order on the applicant. On acceptance of the order by the applicant, the applicant would provide a licence key via e-mail so that the customer would directly download the product through the web link. On these facts, the applicant sought the advance ruling of the Authority on the question "Whether on the facts and circumstances of the case and in law the payment received by Dassault Systems K. K. (hereinafter referred to as `the applicant') from sale of software products to independent third party resellers will be taxable as business profits under article 7 of the India-Japan Double Taxation Avoidance Agreement (`India Japan DTAA' or `Treaty') and will not constitute `royalties and fee for technical services' as defined in article 12 of India-Japan DTAA ?" On the facts stated, the Authority ruled on the question whether the payment would amount to royalty as follows:

> (i) That the computer programme forming part of the software fell within the description of literary or scientific work. A copyright in or over the computer software produced by the applicant was in the nature of an intangible, incorporeal right belonging to the category of intellectual property rights. All intellectual property rights in the licensed programs exclusively belonged to the applicant or its licensor and they were retained by the applicant.
>
> (ii) That passing of a right to use and facilitating the use of a product for which the owner had a copyright was not the same thing as transferring or assigning rights in relation to the copyright. Where the purpose of the licence or the transaction was only to establish access to the copyrighted product for internal business purpose, it was not legally correct to say that the copyright itself had been transferred to any extent. Merely authorizing or enabling a customer to have the benefit of data or instructions contained therein without any further right to deal with them independently did not amount to transfer of rights in relation to copyright or conferment of the right of using the copyright.
>
> (iii) That the VAR had not been given an independent right to sell or offer for sale the software products of the applicant to the end-users. What the VAR did, in the course of carrying out its marketing function, was to canvass for orders, collect the purchase order from the interested customer and forward that offer to the applicant; and it was the applicant that accepted or rejected that offer. In the absence of an independent right to conclude the sale or offer for sale, section 14(b)(ii) of the Copyright Act, 1957, could not be invoked to bring the case

within the fold of article 12(3) of the DTAA or section 9(1)(vi) of the Income-tax Act, 1961.

10. In Para 60 of its judgment the Hon'ble Delhi High Court has accepted the commentary on OECD Model Convention referred to in Dassault Systems KK (Supra), which is as follows:

> "Transfers of rights in relation to software occur in many different ways ranging from the alienation of the entire rights in the copyright in a programme 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 types of payment. The difficulty of determination is compounded by the ease 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.
>
> Payments made for the acquisition of partial rights in the copyright (without the transferor fully alienating the copyright rights) will represent a royalty where the consideration is for granting of rights to use the programme in a manner that would, without such licence, constitute an infringement of copyright. **Examples of such arrangements include licenses to reproduce and distribute to the public software incorporating the copyrighted programme, or to modify and publicly display the programme.** In these circumstances, the payments are for the right to use the copyright in the programme (i.e., to exploit the rights that would otherwise be the sole prerogative of the copyright holder).
>
> In other types of transactions, **the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the programme, for example, where the transferee has limited rights to reproduce the programme. This would be the common situation in transactions for the acquisition of a programme copy. The rights transferred in these cases are specific to the nature of computer programmes. They allow the user to copy the programme, for example onto the user's computer hard drive or for archival purposes.** In this context, it is important to note that the protection afforded in relation to computer programmes under copyright law may differ from country to country.

In some countries the act of copying the programme onto the hard drive or random access memory of a computer would, without a licence, constitute a breach of copyright. However, the copy right laws of many countries automatically grant this right to the owner of software which incorporates a computer programme. Regardless of whether this right is granted under law or under a licence agreement with the copyright holder, copying the programme onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilizing the programme. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the programme by the user, should be disregarded in analyzing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as commercial income in accordance with article7.

The method of transferring the computer programme to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the programme or directly receives a copy on the hard disc of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software."

(Underlining by us for emphasis)

11. After referring to the aforesaid OECD Commentary, the AAR in its decision rendered in the case of Dassault Systems KK (supra) observed as follows:

"It has been contended on behalf of the Revenue that the right to reproduce the work in any material form including the storing of it in any medium by electronic means (vide section 14(a)(i) of the Copyright Act) must be deemed to have been conveyed to the end-user. It is pointed out that a CD without right of reproduction on the hard disc is of no value to the end-user and such a right should necessarily be transferred to make it workable. It appears to us that the contention is based on a misunderstanding of the scope of right in sub-clause (i) of section 14(a). As stated in Copinger's treatise on Copyright, "the exclusive right to prevent copying or reproduction of a work is the most fundamental and historically oldest right of a copyright owner". We do not think that such a right has been passed on to the end-user by permitting him to download the computer programme and storing it in the computer for his own use. The copying/ reproduction or storage is only incidental to the facility extended to the customer to make use of the copyrighted product for his internal business purpose. As admitted by the Revenue's representative, that process is necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product. Apart from such incidental facility, the customer has no right to deal with the product just as the owner would be in a position to do. In so far as the licensed material reproduced or stored is confined to the four corners of its business establishment, that too on a non-exclusive basis, the right referred to in sub-clause (i) of section 14(a) would be wholly out of place. Otherwise, in respect of even off-the-shelf software available in the market, it can be very well said that the right of reproduction which is a facet of copyright vested with the owner is passed on to the customer. Such an inference leads to unintended and irrational results. We may in this context refer to section 52(aa) of the Copyright Act (extracted supra) which makes it clear that "the making of copies or adaptation" of a computer programme by the lawful possessor of a copy of such programme, from such copy (i) in order to utilize the computer program, 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 to utilize the computer programme for the purpose of which it was supplied" will not constitute infringement of copyright. Consequently, customization or adaptation, irrespective of the degree, will not constitute "infringement" as long as it is to ensure the utilization of the computer programme for the purpose for which it was supplied. Once there is no infringement, it is not possible to hold that there is transfer or licensing of "copyright" as defined in the Copyright Act and as understood in common law. This is because, as pointed out earlier, copyright is a negative right in the sense that it is a right prohibiting someone else to do an act, without authorization of the same, by the owner.

It seems to us that reproduction and adaptation envisaged by section 14(a)(i) and (vi) can contextually mean only reproduction and adaptation for the purpose of commercial exploitation. Copyright being a negative right (in the sense explained in paragraph 9 supra), it would only be appropriate and proper to test it in terms of infringement. What has been excluded under section 52(aa) is not commercial exploitation, but only utilizing the copyrighted product for one's own use. The exclusion should be given due meaning and effect; otherwise, section 52(aa) will be practically redundant. In fact, as the law now stands, the owner need not necessarily grant licence for mere reproduction or adaptation of work for one's own use. Even without such licence, the buyer of product cannot be said to have infringed the

> owner's copyright. When the infringement is ruled out, it would be difficult to reach the conclusion that the buyer/licensee of product has acquired a copyright therein."
>
> (underlining by us for emphasis)

12. The above decision of the AAR in the case of Dassault (supra) was a case of sale of shrink wrap software and the AAR has held that reproduction and adaptation envisaged by section 14(a)(i) and (vi) can contextually mean only reproduction and adaptation for the purpose of commercial exploitation.

13. The ruling of the AAR in the case of Dassault (supra) was approved by the Hon'ble Delhi High Court in the case of DIT Vs. Ericsson AB,New Delhi (supra). It can therefore be said that the Hon'ble Delhi High Court has held that consideration paid merely for right to use cannot be held to be royalty. This ratio laid down by the Hon'ble Delhi High Court would also apply when shrink wrap software is sold.

14. Following the view expressed by the Hon'ble Dellhi High Court in the case of DIT Vs. Ericsson AB, New Delhi (Supra), which is favourable to the Assessee, we hold that the consideration received by the Assessee for software was not royalty. The receipts would constitute business receipts in the hands of the Assessee. Admittedly the Assessee who is a non resident does not have a permanent establishment and therefore business income of the Assessee cannot be taxed in India in the absence of a permanent establishment.

15. For the reasons given above, we confirm the order of CIT(A) and dismiss the appeal of the Revenue.

Order pronounced in the open court on the 8th day of Feb.2012.

Sd/- Sd/-

(P.M.JAGTAP) (N.V.VASUDEVAN)
ACCOUNTANT MEMBER JUDICIAL MEMBER

Mumbai, Dated. 8th Feb. 2012.

Copy to: 1. The Appellant 2. The Respondent 3. The CIT City –concerned
4. The CIT(A)- concerned 5. The D.R"L" Bench.

(True copy) By Order

Asst. Registrar, ITAT, Mumbai Benches
MUMBAI.

Vm.