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**WORLD COURIER (INDIA) PVT. LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX
IN THE ITAT BANGALORE BENCH 'A'**

N.V. VASUDEVAN, VP & CHANDRA POOJARI, AM.

ITA Nos. 1727, 1577/Bang/2017

Aug 11, 2021

(2021) 62 CCH 0427 BangTrib

Legislation Referred to

Section 40a(ia), 195

Case pertains to

Asst. Year 2012-13, 2014-15

Decision in favour of:

Matter remanded

TDS— Payment to non-resident —Non deduction of TDS— Assessee company a wholly owned subsidiary of W provides specialized courier services and supply chain services to domestic and overseas customers — Assessee filed return of income — AO noticed that assessee had paid a sum to its overseas group company W — AO was of view that above said payment to non-resident was in nature of royalty and therefore was taxable in India — Since assessee did not deduct tax at source while making payment to aforesaid non-resident as required under section 195 — AO was of view that sum claimed as deduction should be disallowed and added to total income of assessee — AO held that payment in question was in nature of royalty as it is a payment for a right to use software and he accordingly disallowed claim of assessee for deduction of a sum AO however, allowed depreciation on computer software at 60% — CIT(A) confirmed order of AO — Held, decision of Karnataka High Court in case of CIT vs. Samsung Electronics Ltd. 345 ITR 494 on basis of which revenue authorities concluded that payment in question is in nature of royalty, now stand overruled by decision of Supreme Court in case of Engineering Analysis Centre of Excellence (P) Ltd — Court held that a licence from a copyright owner, conferring no proprietary interest on licensee, does not involve parting with any copyright — It said this is

different from a licence issued under section 30 of Copyright Act, which grants licensee an interest in rights mentioned in section 14(a) and 14(b) of Copyright Act — What is 'licensed' by foreign, non-resident supplier to distributor and resold to resident end-user, or directly supplied to resident end-user, is sale of a physical object which contains an embedded computer program — Therefore, it was a case of sale of goods — Payments made by end-users and distributors are akin to a payment for sale of goods and not for a copyright license under Copyright Act — Since end-user only gets right to use computer software under a non-exclusive licence, ensuring owner continues to retain ownership under section 14(b) of Copyright Act read with sub-section 14(a) (i)-(vii), payments for computer software sold/licenced on a CD/other physical media cannot be classed as a royalty — Facts and circumstances under which this addition is made by AO under section 40a(ia) are identical to facts and circumstances as it prevailed in Assessment Year 2014-15 — Issue is remanded to AO for fresh consideration with certain directions — Said directions and decisions will equally apply to present Assessment Year also — Matter remanded .

Held

Decision of Karnataka High Court in case of CIT vs. Samsung Electronics Ltd. 345 ITR 494 on the basis of which the revenue authorities concluded that the payment in question is in the nature of royalty, now stand overruled by the decision of the Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd..

(para 11)

Court held that a licence from a copyright owner, conferring no proprietary interest on the licensee, does not involve parting with any copyright. It said this is different from a licence issued under section 30 of the Copyright Act, which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. What is 'licensed' by the foreign, non-resident supplier to the distributor and resold to the resident end-user, or directly supplied to the resident end-user, is the sale of a physical object which contains an embedded computer program. Therefore, it was a case of sale of goods. The payments made by end-users and distributors are akin to a payment for the sale of goods and not for a copyright license under the Copyright Act.

Since the end-user only gets the right to use computer software under a non-exclusive licence, ensuring the owner continues to retain ownership under section 14(b) of the Copyright Act read with sub-section 14(a) (i)-(vii), payments for computer software sold/licenced on a CD/other physical media cannot be classed as a royalty.

(para 12)

Facts and circumstances under which this addition is made by the AO under section 40a(ia) are identical to the facts and circumstances as it prevailed in Assessment Year 2014-15. Issue is remanded to the AO for fresh consideration with certain directions. The said directions and decisions will equally apply to the present Assessment Year also.

(para 14)

Conclusion

Since the end-user only gets the right to use computer software under a non-exclusive licence, ensuring the owner continues to retain ownership under section 14(b) of the Copyright Act read with sub-section 14(a) (i)-(vii), payments for computer software sold/licenced on a CD/other physical media cannot be classed as a royalty.

In favour of

Matter remanded

Cases Referred to

[*DIT vs Ericsson AB \(343 ITR 470\) \(Delhi\)*](#)

Samsung Electronics Co. Ltd., 345 ITR 495 (Karn)

Counsel appeared:

Bharath H. B, CA for the Assessee.: Kannan Narayanan for the Revenue

N. V. VASUDEVAN, VP.

1. These are two appeals by the assessee against two Orders dated 23.05.2017 and 27.04.2017 of CIT(A)-7, Bengaluru, relating to Assessment Years 2012-13 and 2014-15.

2. We will first take up for consideration the appeal for Assessment Year 2014-15. As far this appeal by the assessee is concerned, the only issue that arises for consideration is as to whether the Revenue authorities were justified in disallowing sum paid by the assessee as software maintenance charges to its overseas group companies by invoking section 40a(ia) of the Income Tax Act, 1961 ('the Act').

3. The assessee is a company. It is a wholly owned subsidiary of World Courier (Group) Inc, USA. The assessee provides specialized courier services and supply chain services to domestic and overseas customers. For Assessment Year 2014-15, the assessee filed the return of income declaring total income of Rs.5,93,68,070/-. In the course of assessment proceedings, the AO noticed that the assessee had paid a sum of Rs.1,24,82,818/- to its overseas group company World Courier Management Inc, USA. The AO was of the view that the above said payment to the non-resident was in the nature of royalty and therefore was taxable in India. Since the assessee did not deduct tax at source while making the payment to the aforesaid non-resident as required under section 195 of the Act, the AO was of the view that the sum claimed as deduction should be disallowed and added to the total income of the assessee.

4. The assessee submitted that there was a Management Information System (MIS) maintenance agreement under which the World Courier Management Inc, USA, which was proprietor of softwares which would help the World Courier Group offices located across the globe to track the movements of the courier. The in-house developed software is supported by Information Systems based out of Stamford, Connecticut which is the main computer centre for the World Courier Group and supplies a variety of information to the operating, marketing, sales and finance and administration teams. This also includes Infrastructure Services, which is responsible for the design and availability of IT infrastructure for the World Courier Group. It incurs infrastructure, maintenance and development costs. The development costs may be specific to projects for an individual group entity or related to

development of common international systems. The costs are charged to group entities on the basis of actual user.

5. Under the Software Maintenance Agreement, World Courier Inc. is required to provide inter alia the following services:

- a. Remedial maintenance consisting of diagnosis and corrective action for problems in the operation of the software
- b. Supply of all product upgrades and new releases and installation of such upgrades and new releases
- c. Provide such software and or system enhancements as may from time to time be requested by the Customer, at extra cost
- d. Provide consultancy services in connection with the purchase and operation of computer hardware and software (other than the software to be maintained), including installation and training, as fees to be agreed in advance

6. The assessee submitted that under India - USA Double Taxation Avoidance Agreement (DTAA) as per Article 12(3)(a) of the "Royalty" is defined as "payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematographic films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or information concerning industrial, commercial, or scientific experience." The assessee further submitted that it has no right to use the copyright in the computer programmes and hence the payments of license fee cannot be termed as Royalties under Article 12(3)(a) of the DTAA. The assessee pointed out that it does not have any access to the Source Code and Object Code of the software licensed by World Courier Inc., namely World- STARsm, Net-STARsm, Bio-STARsm, Ops-STARsm, QDB - Quotations Data Base. Further, the assessee does not use such software for any software development activities.

7. Since the definition of "Royalty" and "Fees for Included Services" as per the provisions of the DTAA are more beneficial than those of the Act, the Software Maintenance Fees if at all taxable in India would need to fall within the category of "Royalty and Fees for Included Services" as per Article 12 of the Treaty. The assessee relied on the decision of the Hon'ble Delhi High Court in the case of DIT vs Ericsson AB (343 ITR 470) (Delhi). Further, the proposition that the definition of the term 'royalty' under the Act will not have any overriding impact on the definition of the term 'royalty' as provided under Article 12(3)(a) of the Treaty.

8. The AO did not agree with the submissions made by the assessee and following the decision of the Hon'ble Karnataka High Court in the case of Samsung Electronics Co. Ltd., 345 ITR 495 (Karn), he held that the payment in question was in the nature of royalty as it is a payment for a right to use the software and he accordingly disallowed the claim of the assessee for deduction of a sum of Rs.1,28,84,818/-. He, however, allowed depreciation on computer software at 60% and disallowed a sum of Rs.84,89,691/-.

9. On appeal by the assessee, the CIT(A) confirmed the order of the AO. Aggrieved by the order of the CIT(A), the assessee is in appeal before the Tribunal.

10. Learned Counsel for the assessee placed reliance on the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence Pvt. Ltd., Vs. CIT, Civil Appeal No.s8733 and 8734/2018, judgment dated 02.03.2021 wherein the Hon'ble Supreme Court has taken a view contrary

to the view taken by the Hon'ble Karnataka High Court in the case of Samsung Electronics Co. Ltd., (supra). The learned DR, while relying on the order of the CIT(A), further pointed out that neither the AO nor the CIT(A) have examined the end users licence agreement to find out whether there was any assignment of any copyright and therefore the issue should be remanded to the AO for consideration afresh. He pointed out that agreement in question does not appear to be purely for use of software but consists of other services also and this aspect also should be examined by the AO.

11. We have carefully considered the rival submissions, perused the order of the AO and Ld. CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before us. We find the issue to be decided in the grounds raised by the assessee is in relation to taxability of payment in question in India in the hands of the recipient. The decision of Hon'ble Karnataka High Court in the case of CIT vs. Samsung Electronics Ltd. 345 ITR 494 on the basis of which the revenue authorities concluded that the payment in question is in the nature of royalty, now stand overruled by the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd. (2021) 125 Taxmann.com 42 (SC). The Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd. (2021) 125 Taxmann.com 42 (SC) held that A copyright is an exclusive right that restricts others from doing certain acts. A copyright is an intangible right, in the nature of a privilege, entirely independent of any material substance. Owning copyright in a work is different from owning the physical material in which the copyrighted work may be embodied. Computer programs are categorised as literary work under the Copyright Act. Section 14 of the Copyright Act states that a copyright is an exclusive right to do or authorise the doing of certain acts in respect of a work, including literary work. The Hon'ble Court took the view that a transfer of copyright would occur only when the owner of the copyright parts with the right to do any of the acts mentioned in section 14 of the Copyright Act, 1957(Copyright Act). In the case of a computer program, section 14(b) of the Copyright Act, speaks explicitly of two sets of acts:

1. The seven acts enumerated in sub-clause (a); and
2. The eighth act of selling or giving of commercial rental or offering for sale or commercial rental any copy of the computer program.

The seven acts as enumerated in section 14(a) of the Copyright Act, in respect of literary works are:

1. To reproduce the work in any material form, including the storing of it in any medium electronically;
2. To issue copies of the work to the public, provided they are not copies already in circulation;
3. To perform the work in public, or communicate it to the public;
4. To make any cinematographic film or sound recording in respect of the work;
5. To make any translation of the work;
6. To make any adaptation of the work; and
7. 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 (1) to (6).

The court held that a licence from a copyright owner, conferring no proprietary interest on the licensee, does not involve parting with any copyright. It said this is different from a licence issued under section 30 of the Copyright Act, which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. What is 'licensed' by the foreign, non-resident supplier to the

distributor and resold to the resident end-user, or directly supplied to the resident end-user, is the sale of a physical object which contains an embedded computer program. Therefore, it was a case of sale of goods. The payments made by end-users and distributors are akin to a payment for the sale of goods and not for a copyright license under the Copyright Act. The decision of the Hon'ble Karnataka High Court in the case of CIT Vs. Samsung Electronics Co. Ltd. (2011) 16 taxmann.com 141 (Karn.), on which the revenue authorities placed reliance in making the impugned addition stood overruled by the Hon'ble Supreme Court.

12. On the question whether the provisions of the Act can override the provisions of the DTAA, the Hon'ble Court held that Explanation 4 was inserted in section 9(1)(vi) of the ITA in 2012 to clarify that the "transfer of all or any rights" in respect of any right, property, or information included and had always included the "transfer of all or any right for use or right to use a computer software". The court ruled that Explanation 4 to section 9(1)(vi) expanded the scope of royalty under Explanation 2 to section 9(1)(vi). Prior to the aforesaid amendment, a payment could only be treated as royalty if it involved a transfer of all or any rights in copyright by way of license or other similar arrangements under the Copyright Act. The court held that once a DTAA applies, the provisions of the Act can only apply to the extent they are more beneficial to the taxpayer and therefore the definition of 'royalties' will have the meaning assigned to it by the DTAA which was more beneficial. It was held that the term 'copyright' has to be understood in the context of the Copyright Act. The court said that by virtue of Article 12(3) of the DTAA, royalties are payments of any kind received as a consideration for "the use of, or the right to use, any copyright "of a literary work includes a computer program or software. It was held that regarding the expression "use of or the right to use", the position would be the same under explanation 2(v) of section 9(1)(vi) because there must be, under the licence granted or sales made, a transfer of any rights contained in sections 14(a) or 14(b) of the Copyright Act. Since the end-user only gets the right to use computer software under a non-exclusive licence, ensuring the owner continues to retain ownership under section 14(b) of the Copyright Act read with sub-section 14(a) (i)-(vii), payments for computer software sold/licenced on a CD/other physical media cannot be classed as a royalty.

13. As contended by the learned DR, neither the AO nor the CIT(A) had the benefit of the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd.(supra) and therefore in all fairness, the issue should be remanded to the AO to examine the terms of the agreement under which right were granted to the Assessee in the light of the provisions of the DTAA as to whether the same would amount to royalty. We accordingly remand the issue to the AO. The AO will afford opportunity of being heard to the Assessee in the set aside proceedings. The appeal of the Assessee is accordingly treated as allowed for statistical purpose.

14. ITA No.1727/Bang/2017 : In this appeal, the issue to be decided is as to whether the AO is justified in disallowing a sum of Rs.1,15,68,449/- being software charges on the ground of non-deduction of tax at source. The facts and circumstances under which this addition is made by the AO under section 40a(ia) of the Act are identical to the facts and circumstances as it prevailed in Assessment Year 2014-15. We have already remanded the issue to the AO for fresh consideration with certain directions. The said directions and decisions will equally apply to the present Assessment Year also. We hold and direct accordingly. The other issues raised in the grounds of appeal were not pressed by the learned Counsel for the assessee. The appeal of the Assessee is accordingly treated as partly allowed for statistical purpose.

15. In the result, the appeal for AY 2014-15 is treated as allowed for statistical purpose while the appeal for AY 2012-13 is treated as partly allowed for statistical purposes.

Pronounced in the open court on the date mentioned on the caption page.

Customized Notes

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