IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH: BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER

IT(IT)A No.1415/Bang/2019
Assessment Year : 2016-17

Cisco Systems International B.V. C/o SRBC & Associates LLP (Authorised Representative) "Divyasree Chambers", First Floor, 'A' Wing, # 11 O'Shaughnessy Road, Langford Gardens, Bengaluru 560 025. **PAN NO : AADCC9201D**	**Vs.**	ACIT International Taxation Circle 1(1) Bengaluru
APPELLANT		**RESPONDENT**

Appellant by	**:**	Shri Nageshwar Rao, A.R.
Respondent by	**:**	Ms. Neera Malhotra, D.R.

Date of Hearing	**:**	08.09.2021
Date of Pronouncement	**:**	30.09.2021

O R D E R

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed this appeal challenging the final assessment order dated 15.4.2019 passed by the A.O. for assessment year 2016-17 u/s 143(3) r.w.s. 144C(13) of the Act in pursuance of directions given by Ld. Dispute Resolution Panel (DRP). The Ld. A.R. submitted that the only issue urged by the assessee relates to validity of assessing the sale proceeds of software sold to Indian customers as royalty income.

2. The Ld. A.R. submitted that the assessee is a company incorporated and operating in Netherlands and hence, it is a tax resident of Netherlands. During the year under consideration, the assessee has sold software to Indian customers. The assessee is engaged in business of selling software. The sales proceeds received by the assessee was Rs.1132.10 crores. The A.O. held that the above said sale proceeds constitute royalty both u/s 9)1)(vi) of the Act and under DTAA entered between India and Netherlands. Accordingly the A.O. passed the draft assessment order proposing to assess Rs.1132.10 crores as royalty income in the hands of the assessee. The assessee objected the same by filing its objections before Ld. DRP. However, the Ld. DRP noticed that it has affirmed the view taken by the A.O. in the assessment year 2014-15 by following the decision rendered by Hon'ble High Court of Karnataka in the case of Samsung Electronics Ltd. (345 ITR 494) and certain other decisions. Accordingly, the Ld. DRP rejected the objections filed by the assessee. Accordingly, the A.O. passed the final assessment order determining the income of the assessee at Rs.1132.10 cores.

3. The Ld. A.R. submitted that the A.O. has assessed the sale proceeds of software as royalty in assessment year 2014-15 and 2015-16 also. The assessee has challenged the said decision by filing appeal before ITAT. He submitted that the ITAT has since disposed the appeals vide its orders dated 2.7.2021 passed in IT(IT)A No.2542/Bang/2018 & IT(TP)A No.2812/Bang/201 relating to assessment year 2014-15 & 2015-16 and the Tribunal has deleted the additions by following the decision rendered by Hon'ble Supreme Court in the case of Engineering Analysis Centre for Excellence Pvt. Ltd. Vs. CIT (2021) 125 taxmann.com 432. The Ld. A.R. submitted that the facts prevailing in the instant year is

identical with the facts available in assessment 2014-15 & 2015-16 and hence the decision rendered by coordinate bench may kindly be followed.

4. On the contrary, the Ld. D.R. invited our attention to the draft assessment order more particularly in para 4 of the assessment order. The Ld. D.R. submitted that the assessee has not furnished any details/documents before the A.O. except furnishing certain sample copies of 3 to 4 agreements. Hence, the A.O. was constrained to pass the order after considering the system integrator agreement and software license agreement obtained during the course of hearings for assessment year 2014-15. The Ld. D.R. submitted that the decision rendered by Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (supra) cannot be blindly followed and it is required to examine the agreement entered between the assessee and the buyers of software in order to find out whether there was transfer of copy right. Accordingly, the Ld. D.R. submitted that the entire issues may be restored to the file of the A.O. for examining it afresh and assessee may be directed to furnish the agreements that may be called for by the A.O.

5. In the rejoinder, the Ld. A.R. submitted that the facts prevailing in 2014-15 and in this year are identical. He submitted that there is no change in the agreement entered by the assessee with the buyers of software. He further submitted that the A.O. examined the various clauses of systems integrated agreements and software license agreement and extracted the same in the assessment order of the year under consideration. He submitted that a reading of the clauses extracted by the A.O. would show no copy right is passed on to the buyer of the software. Accordingly, he submitted that the decision rendered by Hon'ble Supreme Court

in the case of Engineering Analysis Centre of Excellence Pvt. Ltd. (supra) will squarely apply to the facts of the present case and hence the sale consideration received by the assessee on sale of software licenses shall not become royalty within the meaning of DTAA entered between India and Netherlands.

6. We heard the rival contentions and perused the record. We notice that the assessee is entering into two types of agreement with its customers namely "Systems integrated agreement" and "Software license agreement". We notice that the A.O. has extracted relevant clauses from both the agreements in the assessment order. For the sake of convenience, we extract below the relevant portion of the assessment order.

> *"6. The relevant portions from the Systems Integrator Agreement are reproduced below:*
> *9.0 INTELLECTUAL PROPERTY RIGHTS AND SOFTWARE LICENSING:*
> *9.1 Subject to the terms and conditions of the Agreement, Cisco grants to Integrator a non-exclusive, non-transferable license. (a) to use the Software and Documentation for Integrator's Internal Use under the terms as set out in Exhibit C; and, (b) during the term of this Agreement to market and Resell the Software (including related Documentation) directly to End Users, solely as permitted by this Section of this Agreement, in the Territory, or, in the case of Special License Software, to grant to End Users Sublicenses to the Special License Software (including related Documentation)subject to the terms and conditions of this Section and the Special License Terms. Any Resale of any item of Software or Documentation to any person or entity other than Integrator itself that is not an End User of such Software or Documentation, including to any other Cisco Integrator purchasing or licensing such Software or Documentation for purposes of Resale, is expressly prohibited.*
>
> *9.2 The license granted herein shall be for use of the Software Documentation in object code format only and solely as provided in Exhibit C. Integrator may not sublicense, to any person or entity, its rights to distribute or sublicense the Software. Integrator shall provide a copy of the applicable Software License Agreement to each End User of the Software prior to installation of the Software.*

7. Further, the following portion from the said agreement clarifies the grant of right to use the name, logo, trademarks and other marks of Cisco.

11.0 TRADEMARK USAGE.

11.1 Cisco grants to Integrator the right to use the name, logo, trademarks, and other marks of Cisco (collectively, the "Marks") for all proper purposes in the sale of Cisco Products and Services to End Users and the performance of Integrator's duties hereunder only so long as this Agreement is in effect. Integrator's use of such Marks shall be in accordance with Cisco's policies including, but not limited to trademark usage and advertising policies, and be subject to Cisco's prior written approval. Integrator agrees not to attach to any Products any trademarks, trade names, logos, or labels other than an aesthetically proper label identifying the Integrator, its location and its relationship to Cisco. Integrator further agrees not to affix any Marks to products other than genuine Products.

8. The relevant portion of the Software License Agreement is reproduced below showing the License restrictions:

2.0 LICENSE RESTRICTIONS

2.1 If CISCO NAM Software is licensed to a Service Provider by an Integrator, Integrator may grant Service Provider the non-exclusive, non-transferable license to distribute Remote Site Software in the Territory to its End Users subject to these Special License Terms on a temporary basis while Service Provider is providing call centre services via the CISCO NAM Software to such End User. Service Provider's license to such End User must be via a Sublicense between Service Provider and End User where this Sublicense meets the requirements set forth in the Agreement to which this Exhibit is attached. Integrator shall ensure that Service Provider is bound and will abide by the Special License Terms for CISCO NAM Software.

9. The relevant portion relating to the Integrator Rights and obligations are shown below:

3. INTEGRATOR RIGHTS AND OBLIGATIONS.

3.1 Resale of Services, Integrator is authorized on a non-exclusive basis, to resell Services to End Users pursuant to the provisions of this Appendix C. Accordingly, upon such resale of any such Services, Integrator shall provide to End User a copy of the corresponding Program Description for each Service resold by Integrator to each End User.

10. The assessee has claimed that the entire receipts pertained to service fees charged by the assessee to its customers in India for

networking domain, relation configuration support etc. It is evident from the agreement that the services are merely incidental to the actual sale of software and grant of remarketing of software. The relevant portion relating to the Rights and obligations of the assessee have been shown in the next page.

3.0 CISCO RIGHTS AND OBLIGATIONS In consideration of the service fee paid by Integrator, Cisco will provide the following services to Integrator:

3.1 Technical Support

3.1.1 Cisco shall provide 24 hour 7 day a week access to Cisco's TAC. Cisco will use its best endeavors to respond to Integrator within one (1) hour for all calls received during Standard Business Hours and to Priority 1 and 2 calls received outside Standard Business Hours. For Priority 3 and 4 calls received outside Standard Business Hours, Cisco will respond no later than the next business day.

3.1.2 Cisco will provide Third Level Support on all Products except Category A Product for which Cisco will provide Second Level Support and Third Level Support.

3.1.3 Cisco will supply the appropriate level of technical resources based on problem priority and elapsed time to assist Integrator with problem resolution and to ensure adherence to Cisco's Problem Prioritization and Escalation Guideline as described in Appendix A. If mutually agreed that Cisco on-site technical resources are required for resolution, Cisco will dispatch the necessary level of technical support to assist Integrator.

3.2 Software support

3.2.1 Software Releases. Cisco will make available Software Updates as follows:

3.2.1.1 For Software under ASD, one (1) compact disc master containing the Update image(s) and update instructions.

3.2.1.2. For category S Product, Maintenance Releases, if released by Cisco, will be provided to Integrator upon request. In order to receive Major Releases and Version Releases, Integrator must subscribe to the SSP Program.

3.2.1.3 For all other Software Updates, if released by Cisco, will be provided to Integrator upon request.

3.2.2 Release Support. Cisco will support each Major Release and Version Release in accordance with the Cisco End-of-Life policy as posted at http://www.cisco.com /end/US/products/products_end-of-life_policy.html.Cisco, in meeting any support obligations, may require an upgrade to a subsequent release.

3.2.3 Software patches. When required, Cisco will provide new Software to Integrator to correct a problem, or provide a network-bootable Software image, as Integrator and Cisco agree.

3.3 Hardware support. Cisco will provide Advance Replacement service for Hardware as follows:

3.3.1 Cisco shall provide Advance Replacement service as follows: Cisco will ship the replacement non-configured Service Part the same business day providing the request for shipment is made prior to 3.00PM Pacific Standard Time, Monday through Friday, excluding Cisco-observed holidays. For requests after 3.00PM Pacific Standard Time, the Advance Replacement will be shipped the following Cisco business day.

3.3.2 All replacements are shipped using Cisco's preferred carrier, freight prepaid by Cisco.

3.3.3 Product used for replacement may be new or equivalent to new, at Cisco's discretion.

3.3.4 The Advance Replacement Service described in Section 3.3.1 for Product supported by Integrator which was purchased prior to the Effective Date of this Exhibit will take effect thirty (30) days after the Effective Date, provided that Cisco may refuse to provide such service for any Product where Cisco in its sole discretion is not satisfied that all required support fees with respect to such Product have been paid.

11. The relevant portion highlighting that the Indian party is licensed to distribute software is shown below:

9.0 SOFTWARE LICENSE: Integrator acknowledges that it may receive Software as a result of services provided under this Exhibit. Integrator agrees that it is licensed to distribute such Software only on Product covered under this Exhibit and subject to the terms and conditions of the Software license granted with the original purchase of the Product and with respect to which all

applicable fees have been paid. Integrator shall not copy, in whole or in part, Software or documentation modify the Software, reverse compile or reverse assemble all or any portion of the Software, or rent, lease, distribute, sell, or create derivative works of the Software. Integrator shall not upgrade to a feature set other than that which was licensed than that which was licensed at the time of original Product purchase unless applicable license fees are paid.

12. From the above details, it is evident that the assessee has entered into sale of software and grant of use and right to use the software and further license to distribute the same to end users and the services claimed to have been offered to the said parties are only incidental to the Integrator Agreement and not the main aspect as projected by the assessee for which no amount has been offered to tax in India."

7. It is the submission of Ld. A.R. that there is no change in terms and conditions of the agreement in the year under consideration also. He submitted that the assessee is not transferring any copy right, but granting only user license. Accordingly, it has been contended that the decision rendered by Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (supra) was rightly applied by the co-ordinate bench in AY 2014-15 and the same should be followed in this year also.

8. In the instant case, we noticed that the AO has extracted relevant clauses of the agreement in the assessment order and they are reproduced by us in the preceding paragraphs. A perusal of the same would show that the assessee is granting license to the integrators and also authorizing the integrator to grant license only for the purpose of using the software. An identical issue of granting license to use software was examined in the context of its taxability as royalty by Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (supra). The Hon'ble Supreme Court examined this question considering four types of situations, which has been narrated as under:-

*"**4.** The appeals before us may be grouped into four categories:*

(i) The first category deals with cases in which computer software is purchased directly by an end-user, resident in India, from a foreign, non-resident supplier or manufacturer.

(ii) The second category of cases deals with resident Indian companies that act as distributors or resellers, by purchasing computer software from foreign, non-resident suppliers or manufacturers and then reselling the same to resident Indian end-users.

(iii) d category concerns cases wherein the distributor happens to be a foreign, dent vendor, who, after purchasing software from a foreign, non-resident esells the same to resident Indian distributors or end-users.

(iv) The fourth category includes cases wherein computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.

9. The Hon'ble Supreme Court analysed sample agreements in respect of all the four categories and gave the following finding:-

> *"**45.** A reading of the aforesaid distribution agreement would show that what is granted to the distributor is only a non-exclusive, non-transferable license to resell computer software, it being expressly stipulated that no copyright in the computer programme is transferred either to the distributor or to the ultimate end-user. This is further amplified by stating that apart from a right to use the computer programme by the end-user himself, there is no further right to sub-license or transfer, nor is there any right to reverse-engineer, modify, reproduce in any manner otherwise than permitted by the license to the end-user. What is paid by way of consideration, therefore, by the distributor in India to the foreign, non-resident manufacturer or*

supplier, is the price of the computer programme as goods, either in a medium which stores the software or in a medium by which software is embedded in hardware, which may be then further resold by the distributor to the end-user in India, the distributor making a profit on such resale. ***Importantly, the distributor does not get the right to use the product at all****.*

46. *When it comes to an end-user who is directly sold the computer programme,* ***such end-user can only use it by installing it in the computer hardware owned by the end-user and cannot in any manner reproduce the same for sale or transfer, contrary to the terms imposed by the EULA.***

47. *In all these cases, the "license" that is granted vide the EULA, is not a license in terms of section 30 of the Copyright Act, which transfers an interest in all or any of the rights contained in sections 14(a) and 14(b) of the Copyright Act, but is a "license" which imposes restrictions or conditions for the use of computer software. Thus, it cannot be said that any of the EULAs that we are concerned with are referable to section 30 of the Copyright Act, inasmuch as section 30 of the Copyright Act speaks of granting an interest in any of the rights mentioned in sections 14(a) and 14(b) of the Copyright Act. The EULAs in all the appeals before us do not grant any such right or interest, least of all, a right or interest to reproduce the computer software. In point of fact, such reproduction is expressly interdicted, and it is also expressly stated that no vestige of copyright is at all transferred, either to the distributor or to the end-user. A simple illustration to explain the aforesaid position will suffice. If an English publisher sells 2000 copies of a particular book to an Indian distributor, who then resells the*

same at a profit, no copyright in the aforesaid book is transferred to the Indian distributor, either by way of license or otherwise, inasmuch as the Indian distributor only makes a profit on the sale of each book. Importantly, there is no right in the Indian distributor to reproduce the aforesaid book and then sell copies of the same. On the other hand, if an English publisher were to sell the same book to an Indian publisher, this time with the right to reproduce and make copies of the aforesaid book with the permission of the author, it can be said that copyright in the book has been transferred by way of license or otherwise, and what the Indian publisher will pay for, is the right to reproduce the book, which can then be characterised as royalty for the exclusive right to reproduce the book in the territory mentioned by the license.

10 After analysing the provisions of Income tax Act, provisions of DTAA, the relevant agreements entered by the assessees with non-resident software suppliers, provisions of Copy right Acts, the circulars issued by CBDT, various case laws relied upon by the parties, the Hon'ble Supreme Court concluded as under:-

"CONCLUSION

168**. Given the definition of royalties contained in Article 12 of the DTAAs mentioned in paragraph 41 of this judgment, it is clear that there is no obligation on the persons mentioned in section 195 of the Income-tax Act to deduct tax at source, as the distribution agreements/EULAs in the facts of these cases* do not create any interest or right in such distributors/end-users, which would amount to the use of or right to use any copyright. ***The provisions contained in the Income-tax Act (section 9(1)(vi), along with explanations 2 and 4 thereof), which deal with

royalty, not being more beneficial to the assessees, have no application in the facts of these cases.

***169**. Our answer to the question posed before us, is that the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in section 195 of the Income-tax Act were not liable to deduct any TDS under section 195 of the Income-tax Act. The answer to this question will apply to all four categories of cases enumerated by us in paragraph 4 of this judgment."*

11. We also notice that the decision rendered by Hon'ble Karnataka High Court in the case of Samsung Electronics Co Ltd (supra) has been reversed by Hon'ble Supreme Court in paragraph 101-102 of its order. Similarly, the decision rendered in the case of Synopsis International Old Ltd (supra) by Hon'ble Karnataka High Court has been reversed in paragraph 103 – 109 of its order. Before us, the Ld. A.R. submitted that the terms of agreements remain the same during the year under consideration also. Accordingly, as per the decision rendered by Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence Pvt. Ltd. (supra), sale proceeds received by the assessee on sale of software licenses cannot be categorized as "Royalty" within the meaning of provisions of DTAA. Accordingly, we set aside the order passed by Ld. CIT(A) on this issue and direct the A.O. to delete the addition made as "royalty" income.

12. In the result, the appeal filed by the assessee is allowed.

Order pronounced in the open court on 30th Sept, 2021.

Sd/- **(N.V. Vasudevan)** **Vice President**	**Sd/-** **(B.R. Baskaran)** **Accountant Member**

Bangalore,
Dated 30th Sept, 2021.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.