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IN THE HIGH COURT OF DELHI AT NEW DELHI

MANMOHAN; SUDHIR KUMAR JAIN, JJ.

ITA 32/2022; ITA 34/2022 & C.M.No.11370/2022; 7th March, 2022

COMMISSIONER OF INCOME TAX (INTERNATIONAL TAXATION)-2 *versus* GRACEMAC CORPORATION

Income Tax Act, 1961; Section 9(1)(vi) - An amount received under a distribution agreement with respect to a computer software did not amount to 'royalty', if the agreement does not create a right to transfer the copyright with respect to it. (Para 4)

Appellant through Mr.Sanjay Kumar, Advocate.

Respondent through Mr.Nageshwar Rao with Ms.Deepika Agarwal, Advocates.

J U D G M E N T

MANMOHAN, J :

1. Present appeals have been filed under Section 260A of the Income Tax Act, 1961 [for short 'Act'] challenging the judgment and order passed by ITAT on 16th November, 2020 for the Assessment Years 2005-2006 and 2007-08.

2. Learned counsel for the appellant-Revenue submits that ITAT has erred in holding that licensing of software products of Microsoft in the Territory of India by the Respondent was not taxable in India as Royalty under Section 9(1)(vi) of the Act read with Article 12 of the Indo US DTAA.

3. He states that the Tribunal has failed to appreciate that the distribution model in the case of the respondent assessee involved making of multiple copies of the software clearly indicating transfer of copyright.

4. Having heard learned counsel for the appellant, this Court finds that the issue raised in the present appeals is no longer *res integra* as the Supreme Court in **Engineering Analysis Centre of Excellence Private Limited vs. Commissioner of Income Tax and Anr., (2021) SCCOnline SC 159** has held 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) The third category concerns cases wherein the distributor happens to be a foreign, non-resident vendor, who, after purchasing software from a foreign, non-resident seller, resells 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.

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97. The AAR then reasoned that the fact that a licence had been granted would be sufficient to conclude that there was a transfer of copyright, and that there was no justification for the use of the

doctrine of *noscitur a sociis* to confine the transfer by way of a licence to only include a licence which transferred rights in respect of copyright, by referring to explanation 2 to section 9(1)(vi) of the Income Tax Act. It then held:

“Considerable arguments are raised on the so-called distinction between a copyright and copyrighted articles. What is a copyrighted article? It is nothing but an article which incorporates the copyright of the owner, the assignee, the exclusive licensee or the licensee. So, when a copyrighted article is permitted or licensed to be used for a fee, the permission involves not only the physical or electronic manifestation of a programme, but also the use of or the right to use the copyright embedded therein. That apart, the Copyright Act or the Income-tax Act or the DTAC does not use the expression ‘copyrighted article’, which could have been used if the intention was as claimed by the applicant. In the circumstances, the distinction sought to be made appears to be illusory.”

98. This ruling of the AAR flies in the face of certain principles. When, under a non-exclusive licence, an end-user gets the right to use computer software in the form of a CD, the end-user only receives a right to use the software and nothing more. The end-user does not get any of the rights that the owner continues to retain under section 14(b) of the Copyright Act read with sub-section (a)(i)-(vii) thereof. Thus, the conclusion that when computer software is licensed for use under an EULA, what is also licensed is the right to use the copyright embedded therein, is wholly incorrect. The licence for the use of a product under an EULA cannot be construed as the licence spoken of in section 30 of the Copyright Act, as such EULA only imposes restrictive conditions upon the end-user and does not part with any interest relatable to any rights mentioned in sections 14(a) and 14(b) of the Copyright Act.

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101. Also, any ruling on the more expansive language contained in the explanations to section 9(1)(vi) of the Income Tax Act would have to be ignored if it is wider and less beneficial to the assessee than the definition contained in the DTAA, as per section 90(2) of the Income Tax Act read with explanation 4 thereof, and Article 3(2) of the DTAA. Further, the expression “copyright” has to be understood in the context of the statute which deals with it, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA. For all these reasons, the determination of the AAR in *Citrix Systems (AAR)* (*supra*) does not state the law correctly and is thus set aside.

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173. 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.

174. The appeals from the impugned judgments of the High Court of Karnataka are allowed, and the aforesaid judgments are set aside. The ruling of the AAR in *Citrix Systems (AAR)* (*supra*) is set aside. The appeals from the impugned judgments of the High Court of Delhi are dismissed.”

5. Further, this Court on similar facts has allowed writ petitions filed by the similarly placed assessee in **EY Global Services Limited vs. Assistant Commissioner of Income Tax & Anr, W.P.(C) 11957/2016** and **EYGBS (India) Private Limited vs. Joint Commissioner of Income Tax & Ors., W.P.(C) 12003/2016**. The relevant portion of the said judgment is reproduced hereinbelow:-

“...13. A reading of the above judgment would clearly show that for the payment received by EYGSL (UK) from EYGBS (India) to be taxed as ‘royalty’, it is essential to show a transfer of copyright in the software to do any of the acts mentioned in Section 14 of the Copyright Act, 1957. A licence conferring no proprietary interest on the licensee, does not entail parting with the copyright. Where the core of a transaction is to authorise the end-user to have access to and make use of the licenced software over which the licensee has no exclusive rights, no copyright is parted with and therefore, the payment received cannot be termed as ‘royalty’.

14. In the present case, the EYGBS (India), in terms of the Service Agreement and the MOU, merely receives the right to use the software procured by the EYGSL (UK) from third-party vendors. The consideration paid for the use of the same therefore, cannot be termed as ‘royalty’ as held by the Supreme Court in Engineering Analysis Centre (supra). In determining the same, the rights acquired by the EYGSL (UK) from the third-party software vendors are not relevant. What is relevant is the Agreement between the EYGSL (UK) and the EYGBS (India). As the same does not create any right to transfer the copyright in the software, the same would not fall within the ambit of the term ‘royalty’ as held by the Supreme Court in Engineering Analysis Centre (supra).

15. We may also note that the learned AAR in its Impugned Order has relied upon its earlier view in Citrix Systems Asia Pacific Pty Ltd., In Re., (2012) 343 ITR 1 (AAR), which has been expressly stated to be bad law in Engineering Analysis Centre (supra).

16. The submission of the learned counsel for the Revenue that the judgment of the Supreme Court in Engineering Analysis Centre (supra) cannot be applied because it confines itself only to the four categories mentioned in paragraph 4, also cannot be accepted. Though the Supreme Court was on facts considering the four categories of cases that arose in the appeals before it, it has laid down the law for general application. The law, as laid down by the Supreme Court, when applied to facts of the present case, squarely covers the same in favour of the petitioners.

17. The submission made by the learned counsel for the revenue relying upon the amendment to Section 9(1)(vi) of the Income Tax Act, 1961 has also been specifically considered and rejected by the Supreme Court.

18. In view of the above, the Impugned Rulings dated 10.08.2016 passed by the learned AAR are set aside and it is held that the payment received by EYGSL (UK) for providing access to computer software to its member firms of EY Network located in India, that is, EYGBS (India), does not amount to ‘royalty’ liable to be taxed in India under the provisions of the Income Tax Act, 1961 and the India-UK DTAA.”

6. Since, the issue of law raised in the present appeals has been conclusively decided in the favour of the assessee by the Supreme Court, no substantial question of law arises for consideration in the present appeals. It is also pertinent to mention that the appellant had admitted before the ITAT that the dispute in question had been decided in favour of the assessee by the Tribunal in earlier years. Accordingly, the present appeals are dismissed.

7. At this stage, learned counsel for the appellant states that there are other connected appeals pending before this Court. Registry is directed to list the connected appeals being ITA Nos.203/2017, 267/2017, 940/2019, 942/2019, 943/2019, 419/2019, 432/2019 and 611/2019 on 23rd March, 2022.