IN THE INCOME TAX APPELLATE TRIBUNAL DELHI

(DELHI BENCH 'D' : NEW DELHI)

BEFORE SH. R.K.PANDA, ACCOUNTANT MEMBER
AND
SH. ANUBHAV SHARMA, JUDICIAL MEMBER

ITA No.1554/Del/2016
(Assessment Year : 2012-13)

M/s. MOL Corporation C/o. Mr. Aakash Uppal (Director) SRBC & Associates LLP 6th Floor, Wing A & B, Worldmark a, Aero city, Opp. Holiday Inn, Mahipalpur, New Delhi-110037 PAN – AAFCM9676A	Vs.	DCIT (International Taxation) Circle-Gurgaon, Gurgaon
(APPELLANT)		**(RESPONDENT)**

Assessee by	Shri Nageshwqar Rao, Adv., Deepika Agarwal, Adv.
Revenue by	Ms. Anupama Anand, CIT-DR

Date of hearing:	30.03.2022
Date of Pronouncement:	13.04.2022

ORDER

PER ANUBHAV SHARMA, JM:

The appeal has been preferred against the order dated 23.12.2015 of Dispute Resolution Panel-1, New Delhi for assessment year 2012-13 u/s 144C(5) of the Income Tax Act, 1961 and assessment order dated 19.02.2016 passed by Dy.

Commissioner of Income Tax, International Tax, Gurgaon u/s 143(3) read with section 144C(13) of the Act.

2. The facts with regard to the matter in hand as can be picked from record are that Microsoft Corporation, USA, ('MS Corp') is the ultimate parent entity of assessee MOL Corporation ('MOLC') which itself is a company incorporated in the United States of America, having its registered office in USA. Gracemac Corporation ***('Gracemac'), is*** a corporation incorporated in the USA and a Wholly Owned Subsidiary of MS Corp which got merged with MOLC with effect from 2nd October 2006. All the rights and obligations of Gracemac got merged into the affairs of MOLC.

2.2 'MS Corp' is the sole owner of intellectual property rights vested in Microsoft Software. It has granted **exclusive license** to manufacture and distribute Microsoft products to one of its wholly owned subsidiary M/s Gracemac (now merged with MOL Corporation, the assessee in this case), which, in turn granted non-exclusive rights to its wholly owned, subsidiary, Microsoft Operations Pte.Ltd., Singapore, ("MO Singapore"), to manufacture Microsoft Products in Singapore and distribute such products in Asia (excluding non-English-Ianguage products in China and Taiwan). M/s Microsoft Regional Sales Corporation(MRSC) has been appointed as a distributor of Microsoft products in Asia by MO, Singapore.

2.3 MS Corp entered into an agreement with Gracemac on 1sl January 1999 and granted the following rights to Gracemac (Now MOL, the assessee):

- exclusive license to manufacture and distribute Microsoft retail software products directly to retailers or to MS Corp or to subsidiaries of MS Corp; and
- exclusive right to license any third party, to directly grant customers the right to use for internal use.

Following the merger of Gracemac with MOLC, by operation of law, the exclusive license belonging to Gracemac was assigned in favour of MOLC.

2.4 In pursuance of the above rights, MOLC has entered into a License Agreement with Microsoft Operations Pte Ltd. ('MO'), a company incorporated under the laws of Singapore), which has been made effective from 1st July 2006. Under the said License Agreement, MOLC has granted MO the non-exclusive rights to:

- manufacture the licensed Microsoft products (softwares) in Singapore;
- license and distribute such products

2.5 MO, in turn, has entered into a Distribution Agreement with Microsoft Regional Sales Corporation ('MRSC') vide which it has allowed MRSC to License and distribute Microsoft's software products in India, amongst other countries. The MRSC is engaged in licensing of software through independent distributors to the end users under an End User License Agreement (EULA),

2.6 In lieu of the above-mentioned rights vested in it through an exclusive license, the ultimate beneficiary of the licensing of Microsoft software products to end users in India was considered to be the assessee (MOL Corp.)

3. The assessee did not show any income in its return for the relevant assessment year. Though it had received a total consideration of INR 3,373,74,00,209/- as revenue from licensing of MS Software products. Apart from this a revenue of Rs. 11,35,98,751/- was also been received from online services termed as “Cloud Services”.

3.1. Earlier in the appeals, the Tribunal disposed of the appeals of the assessee holding that in the light of Hon’ble Delhi High Court Judgment in **DIT vs. Infrasoft Ltd. [2014] [220 Taxman 273]** where Hon’ble Delhi High Court had held sale of software cannot be qualified as royalty and directed law tax authorities to decide the issue of the assessee and remanded back the matter to the file of AO.

3.2 Ld. AO considered the nature of income arising to the assessee on account of the licensing of software to be taxable **as** Royalty substantively in the hands of the assessee. Ld. DRP and the ld. AO had both distinguished the judgment of Hon'ble Delhi High Court in **Infrasoft Ltd. case.** The ld. AO observed in his order dated 19.02.2016 in para no. 7.8 as under :-

> ***"7.8 Regarding non-applicability of Infrasoft Ltd. Case, 220 Taxman 273 (2014), decision dated 22.11.2013***
>
> *Similarly in a recent judgement in the case of Infra soft Ltd (ITA No. 1034/2009 dated 22-11-2013), the Hon'ble Delhi High Court has not adjudicated upon the grounds raised by the revenue relating to the applicability of the amended provisions of section 9(1)(vi). The Court has broadly relied upon the Article 3(2) of the India-USA Treaty in deciding the issue in favour of the assessee. From the bare reading of the above Article it is evident that since the language of the definition under the Income Tax Act and DTAA are same, for the purpose of interpreting article 1 2(3) of the India USA treaty, Explanation 4 to the section 9(1}(vi) of the income Tax Act ought to be necessarily read by invoking article 3(2). Since the meaning of use of copyright right in the context of software taxation has been* ***clarified bv Finance Act,2012*** *(which is not an* ***extension of the scope*** *of Royalty Provisions under the IT Act), both the contracting states to the DTAA convention have agreed that reference to the domestic laws can be made where the treaty requires to do so. This aspect has been omitted to be looked into by the Hon'ble Court and is a subject matter of further appeal by the Revenue.*

4. Further the AO had considered the receipts from Cloud Services as user based on royalty observing that the Microsoft online subscription agreement mentions that the software underlying the service in each kind of model i.e. PAAS / SAAS / IAAS is license to the customer and not sold. The software is protected by patent, copyright and trade mark protections, therefore the AO held the payments made by the users as the consideration for the use or the right to use of

such patents, Software and Cloud Infrastructure covering them in the definition of royalty both by clause 9 (1)(vi) Explanation 2 sub-clause (iii) and (v) of the Income Tax Act, 1961 and also Article 12 (3) of the India US, DTAA. The addition in hands of assessee was made on substantive basis and protectively in the case of M/s Microsoft Regional Sales Corporation(MRSC).

5. Thus, the assessee has come before the Tribunal raising following grounds of appeal :-

1. *That on facts and in law, the Dy. Commissioner of Income Tax, Circle - 'Gurgaon', International Taxation, Gurgaon ('Learned AO') erred in computing the total income of the Appellant at INR 33,85,09,98,960 as against 'Nil' income reported in the return of income by the Appellant.*

2. ***Taxability of revenue from sale of software***

2.1 *That on the facts and in law, the Hon'ble Dispute Resolution Panel ('Hon'ble DRP') and the Learned AO erred in observing that amount paid by Microsoft Operations Pte Ltd. ('MO') to Appellant was for earning income from a source in India.*

2.2 *That on facts and in law, the Hon'ble DRP and the Learned AO erred in holding that the revenue earned and received from sale of software by MRSC is taxable in India as Royalty in the hands of the Appellant without appreciating that the same is not in the nature of Royalty under Article 12 of the India - USA DTAA and is not taxable in India.*

2.3 That on facts and in law, the Hon'ble DRP and the Learned AO grossly erred in not following the judgment of the Hon'ble jurisdictional High Court in the case of **DIT vs. Infrasoft Ltd (ITA 1034/2009)** *which is binding on the lower tax administrative bodies and the other judicial precedents as the same is squarely applicable in the case of Appellant.*

2.4 That on facts and in law, the Hon'ble DRP and the Learned AO failed to appreciate that the sale of software is a sale of 'Copyrighted Article' and not 'Copyright' and accordingly, the revenue from sale of software is in the nature of business income not taxable under Article 7 of India US tax treaty in the absence of the PE of the Appellant in India.

2.5 Without prejudice to the below mentioned grounds of appeal, the Hon'ble DRP and Learned AO erred on the facts of the case and in law, in determining the income of the Appellant for the subject Assessment Year at INR 33,73,74,00,209 thereby completely ignoring the fact that the payments received by the Appellant from licensing of manufacturing and distribution rights to MO pertaining to India was INR 20,24,24,40,125 only.

3. Taxability of the revenue from cloud services

3.1 That on facts and in law, the Hon'ble DRP and the Learned AO erred in observing that amount paid by MO to Appellant was for earning income from a source in India.

3.2 That on facts and in law, the Hon'ble DRP and the Learned AO erred in not holding that the revenue earned by MRSC from cloud services amounting to INR 11,35,98,751 is taxable as Royalty in India in the hands of the Appellant without appreciating that the same is not in the nature of Royalty under the India - USA DTAA and is not taxable in India.

3.3 Without prejudice to the above, the Hon'ble DRP and the Learned AO erred on facts and in law in determining income of the appellant from cloud services as INR 11,35,98,751, thereby completely ignoring the fact that the payments received from licensing of cloud services rights to MO pertaining to India was INR 6,81,59,251 only.

Transfer of TPS credit

4 That on facts and in law, the Learned AO grossly erred in not transferring the TDS credit claimed by MRSC to MOLC in view of the mandatory directions of Hon'ble DRP and the law laid down by the Supreme Court in the decision of ITO vs. Bachu Lai Kapoor (60 ITR 74) (1966) (SC).

Penalty Proceedings

5 That on facts and in law, the Learned AO has erred in initiating penalty proceedings under section 271(l)(c) of the Act against the Appellant.

The above grounds of appeal are mutually exclusive and without prejudice to each other. The appellant craves leave to add, alter, amend and / or modify any of the grounds of appeal at or before the hearing of the appeal.

The appellant prays for appropriate relief based on the said grounds of appeal."

6. Heard and perused the record. The Ld. AR restricted his arguments to

ground no 1 to 3 only and same are taken up below for determination.

Ground no 1 and 2 with their sub grounds.

7. On behalf of the assessee in regard to **ground no 1** it was submitted that Ld. Tax Authorities have failed to follow the ratio and principles of law in regard to the sale of software products not giving rise to royalty income as held by Hon'ble Delhi High Court in DIT vs. Infrasoft Ltd. (2014) 220 Taxman. 273. It was submitted that Hon'ble Supreme Court of India in its judgment dated 02.03.2021 in **Engineering Analysis Centre of Excellence (P) Ltd. vs. Commissioner of Income Tax (2021) 125 taxmann.com 42 (SC)** has upheld the Hon'ble Delhi High Court judgment. It was submitted that in the case of Gracemac Corporation which stands amalgamated with MOL Corporation for the assessment year 2005-06, 2006-07 and 2007-08 the Co-ordinate Bench B at Delhi by order dated 16.12.2020 has allowed the appeals which have been further upheld by Hon'ble Delhi High Court by judgment dated 07.03.2022. The Ld. DR supported the findings of Tax authorities below.

7.1 Giving thoughtful consideration to the matter on record, the Bench is of considered opinion that the revenue has been following a persistent approach in regard to assessee and its sister assessee subsidiaries of MS Corp holding sale of MS Retail Software Products to Indian Distributors as royalty under the Act as well as under DTAA between India and US. The assessment in the hands of present assessee was made on substantive basis while the protective assessment was in the hands of M/s Microsoft Regional Sales Corporation(MRSC). The assessments in the hands of Gracemac which stands amalgamated with the assessee stands set aside in regard to assessment years 2005-06, 2006-07 and 2007-08 by the co-ordinate Bench's judgment dated 16.11.2020 which have been further upheld by Hon'ble Delhi High Court by judgment dated 07.03.2022. The same were based on the principles of law that sale of software products does not give rise to royalty income

as laid down by the Hon'ble Delhi High Court in **Infrasoft Ltd. case** which have now further been affirmed by the Hon'ble Supreme Court of India in the case of **Engineering Analysis Centre of Excellence P. Ltd. (supra).**

7.2 In the light of aforesaid as there are no distinguishing facts with regard to present assessment years and as this Bench has also allowed the similar grounds for the assessment year AY for 2010-11, 2011-12 and 2012-13, vide order of even date in regard to M/s Microsoft Regional Sales Corporation(MRSC), the grounds in hand are sustained. The assessment order for AY for 2012-13 is liable to be set aside.

Ground no 3

8 It was submitted for the assessee that Ld. Tax Authorities below have failed to appreciate the functional aspects of Cloud base service while holding the subscription to cloud base service as royalty. In this context, the co-ordinate bench judgment, in which one of the members of this bench was also a member, in M/s. Salesforce.com Singapore Pte. Vs. Dy. D.I.T. Circle-2(2) ITA No. 4915/DEL/2016 [A.Y 2010-11] with six other connected was relied to contend that subscription to the cloud computing services do not give rise royalty income. He also relied the Mumbai Bench judgement in the cases of Rackspace , Us Inc., Usa vs Dcit (It) - 4(1)(1) ITA no 1634//mum/2016, I.T. A Nos.6195 & 4920/Mum/2018 and 5250 (MUM)of 2019 for the same proposition. A The Ld DR supported the findings of Tax authorities below.

8.1 Giving thoughtful consideration to the matter on record, the bench is of considered view that the cloud base services do not involve any transfer of rights to the customers in any process. The grant of right to install and use the software included with the subscription does not include providing any copy of the said software to the customer. The assessee's cloud base services are though based on patents / copyright but the subscriber does not get any right of reproduction. The

services are provided online via data centre located outside India. The Cloud services merely facilitate the flow of user data from the front end users through internet to the provider's system and back. The ld. AO has fallen in error in interpreting it as licensing of the right to use the above Cloud Computing Infrastructure and Software (para 10.5 of the Ld. AO order). Thus the subscription fee is not royalty but merely a consideration for online access of the cloud computing services for process and storage of data or run the applications.

8.2 While dealing with similar question in regard to the case of **M/s. Salesforce.com Singapore Pte. (supra)** where the said assessee was provider of comprehensive customer relationship management servicing to its customer by using Cloud Computing Services / Web Casting Services, the Bench in its order dated 25.03.2022 held as under :

> *"28. Considering the facts of the case in totality, in light of the Master Subscription Agreement, we are of the considered view that the customers do not have any access to the process of the service provider i.e. the assessee, and the assessee does not have any access except otherwise provided in the master subscription agreement to the data of the subscriber.*
> *29. In our considered opinion, all the equipments and machines relating to the service provided by the assessee are under its control and are outside India and the subscribers do not have any physical access to the equipment providing system service which means that the subscribers are only using the services provided by the assessee."*

8.3 The Mumbai Tribunal in the case of **DDIT v Savvis Communication Corporation [2016] 69 taxmann.com 106 (Mumbai – Trib.)** has held that payment received for providing web hosting services though involving use of certain scientific equipment cannot be treated as 'consideration for use of, or right to use of, scientific equipment' which is a sine qua non for taxability under section 9(1)(vi), read with Explanation 2 (iva) thereto as also article 12 of Indo-US DTAA.

The Chennai Tribunal in the case of **ACIT v Vishwak Solutions Pvt. Ltd ITA No. 1935 & 1936/MDS/2010 dated 30.01.2015** has upheld the findings of CIT(A) that **"the amount paid to the non-resident is towards hiring of storage space."**

8.4 In the case of Rackspace , Us Inc., Usa vs Dcit (It) -4(1)(1), Mumbai, I.T. A Nos.6195 & 4920/Mum/2018 for the Assessment Years 2010-11 & 2015-16 the Mumbai Bench of the Tribunal has also considered similar issue where the assessee filed the return of income and the notes stating therein that the cloud hosting services was not taxable as 'royalties' under Article 12 of the India-US tax treaty as the customers do not operate the equipment or have physical access to or control over the equipment used by the assessee to provide cloud support services and do not make available technical knowledge, experience, skill, know-how etc., to its Indian Customers and the cloud support services are not in the nature of managerial, technical or consultancy services and consequently same do not constitute fees for included services within the meaning of Article 12 of the India-USA Double Tax Avoidance Agreement (DTAA). It was observed by the Bench, while following the assessee's own case judgment for other years that

> *"5. On appraisal of the above mentioned finding, we find that the agreement between the assessee and its customers is for providing hosting and other ancillary services to the customers and not for the use of leasing any equipment. The data centre and the infrastructure therein used to provide these serves belongs to the assessee. The customers are not having physical control or possession over the servers and right to operate and manage this infrastructure/servers vest solely with the assessee. The agreement is to provide hosting services simpliciter and is not for the purpose of giving the underlying equipment on hire or lease. The customer was not knowing any location of the server in data centre, web mail, websites etc. Accordingly, it cannot be said as royalty within the meaning of Explanation (2) to Section 9(1)(vi) of the Act as well as Article 12(3)(b) of the Indo-USA Data by the AO and DRP. Moreover, there is no PE of the assessee in India*

and hence, no income can be taxed in India in term of Indo-US DTAA."

8.5 The aforesaid judgments squarely covers the controversy in regard to the present assessee also. In the light aforesaid, the Bench is of considered view that the ld. Tax Authorities below had fallen in error in considering the subscription received towards Cloud Services to be royalty income.

9. **Accordingly the grounds no 1 to 3 in appeal are allowed and the impugned orders are set aside.**

Order pronounced in open court on this 13th day of April, 2022.

Sd/-	**Sd/-**
(R.K.PANDA)	**(ANUBHAV SHARMA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Date:-13.04.2022
Binita, SR.P.S

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