* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **INCOME TAX APPEAL NOS. 93/2002 & 120/2008**

Reserved on: 3rd December, 2014

% **Date of Decision:** 3rd February, 2015

HCL LIMITED ..... Appellant

Through Mr. Ajay Vohra, Sr. Advocate with Ms. Kavita Jha & Mr. Vivek Bansal, Advocates.

Versus

THE COMMISSIONER OF INCOME TAX NEW DELHI ….. Respondent

Through Ms. Suruchi Aggarwal, Sr. Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J.:

HCL Infosystems Limited, formerly known as HCL Limited, a representative assessee of Apollo Domain Computers, GmbH Germany, has filed these two appeals under Section 260A of the Income Tax Act, 1961 (Act, for short) pertaining to Assessment Years 1989-90 and 1990-91.

2. By order dated 9th October, 2002, ITA No. 93/2002 was admitted for hearing on the following substantial question of law:

> "Whether the Tribunal was right in holding that the lump sum payment of Rs. 1,11,38,650/- to the assessee, by M/s Apollo Domain Computers West Germany, under agreement, dated 11th May, 1987, was liable to tax under the Act ?"

By order dated 19th August, 2008, ITA No. 120/2008 was admitted for hearing on the following substantial question of law:-

> "Whether the Income Tax Appellate Tribunal was correct in law in holding that the lump sum payment of Rs.50,51,050/- ($365,500) by the assessee to M/s Apollo Domain Computers, West Germany, under the agreement dated 11.05.1987 was liable to tax under the Income Tax Act, 1961?"

3. As the issue and the substantial questions of law involved in these two appeals are same, they are being disposed of by this common decision. For the sake of clarity we record that the impugned order passed by the Income Tax Appellate Tribunal (Tribunal, for short) in ITA No. 93/2002 is dated 14th August, 2001 and the impugned order in ITA No. 120/2008 is dated 31st May, 2006. The latter order merely follows the earlier order impugned in ITA No. 93/2002 and, therefore, we will be referring to the facts relevant for the Assessment Year 1989-90. For the sake of clarity and understanding, we have referred to HCL Infosystems Limited as HCL and Apollo Domain Computers, GmbH Germany as ADC in this judgment.

4. Succinctly put, the issue raised in the present appeals is whether payments of Rs.1,11,38,650/- and Rs 50,51,050 made by HCL to ADC in terms of the inter se agreement dated 11th May, 1987 was royalty under Article VIIIA of the Double Taxation Avoidance Agreement (DTAA, for short) between India and the then Federal Republic of Germany. The aforesaid DTAA was notified on 13th September, 1960. Article VIIIA was inserted subsequently after protocol was signed on 28th June, 1984 and ratified on 10th July, 1985. As the said article arises for consideration, we deem it appropriate to reproduce the entire Article:-

> " ARTICLE VIIIA

(1)Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

(2)However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that State. But insofar as the fees for technical services are concerned, the tax so charged shall not exceed 20 per cent of the gross amount of such fees.

(3) The term "royalties" as used in this Article means 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 including cinematograph films of films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

(4) The term "fees for technical services" as used in this Article means payments of any kind to any person, other than payments to an employee of the person making the payments, in consideration for services of a managerial, technical or consultancy nature, including the provision of services of technical or other personnel.

(5) The provisions of paragraphs (1) and (2) of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, and the right, property or contract in respect of which the royalties or fees or technical services are paid is effectively connected with such permanent establishment. In such case, the provisions of Article III shall apply.

(6) Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a land, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to make the payments was incurred and the payments are borne by that permanent establishment, then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

> (7) Where, owing to a special relationship between the payer and some other person, the amount of the royalties or fees for technical services paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Agreement."

5. In order to appreciate the ambit and scope of term 'royalty' and what would be taxable under Article VIIIA of DTAA, there was exchange of notes between the contracting States on 28th June, 1984 and the relevant portion reads:-

> "3. Notwithstanding the provisions of paragraph (3) of Article III of the Agreement, no deduction shall be allowed in respect of amounts paid or charged (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of-
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> (a) royalties, fees or similar payments in return for the use of patents or other similar rights;
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> (b) commission for specific services performed or for management; and
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> (c) interest on moneys lent to the permanent establishment, except in the case of a banking institution.
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> 4. It is understood that the deductions in respect of the head office expenses as referred to in paragraph (3) of Article III of the Agreement shall in no case be less than what are allowable under the Indian Income-tax Act as on the date of entry into force of this Protocol.
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> 5. It is understood that the taxation of royalty income as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, shall not exceed 20 per cent of the gross amount of such payments."

6. At the outset, we deem it appropriate to record that it is a case of HCL Limited that provisions of Article VIIIA of DTAA being more beneficial than the provisions of the Act, the same would be applicable.

The respondent-Revenue has not joined *lis* on the said score. Explanation 2 to Section 9(1)(vi) of the Act brings within the ambit of royalty a wider range of transactions, which would include payments made for transfer of all or any rights or patents, invention, model designs, etc. The said Explanation which defines the term royalty is, therefore, not restricted to payments based on use of or right to use such right, patent, invention, model, design, secret formula or process or trademark or similar property. Our decision, therefore, does not proceed on Explanation 2 to Section 9(1)(vi) of the Act, but the term "royalty" as defined and covered under Art VIII A of the DTAA.

7. Before we examine the relevant clauses of agreement dated 11th May, 1987 between HCL and ADC, it would be first appropriate to examine the ambit and scope of the term 'royalty' taxable under Article VIIIA of the DTAA. The said article applies to 'royalties' and 'fee for technical services' arising in one contracting State and paid to the resident of the other contracting State. Royalties and fee for technical services can be taxed in the source State, i.e., the State from where the payment is made in accordance with the laws of the State, but the tax so charged cannot exceed 20% of the gross amount of such fee. Therefore, 'royalty' or 'fee for technical services' paid by HCL to ADC would be taxable in India as this is the State from where payments arose and knowhow was utilized, in accordance with the laws in India but the tax so charged cannot exceed 20% of the gross amount of such fee. To this extent also, the parties are *ad idem* and there is no dispute. The dispute is whether the payments made under the agreement dated 11th May, 1987 are 'royalty' within the meaning of clause (3) of Article VIIIA of the DTAA. The term 'royalty' has been defined in the said clause to mean payments of any kind received as a consideration for use of, or right to use any copyright of literary, artistic or

scientific work including cinematographic films or films or tapes used for radio or television broadcasting, any patent, trade mark ,design or model, plan, secret formula or process, or for use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience. The said Article is in consonance with the UN Model Tax Treaties rather than OECD Model. The use of the words "right to use industrial, commercial or scientific equipment" expands the ambit and scope of the term 'royalty' in Article VIIIA. The term "royalties" in 1963 draft convention and the 1977 Model OECD Convention included payments "for use of, or the right to use, industrial, commercial or scientific equipment", but reference to these payments was subsequently deleted. The term 'royalty' as used in the Article refers to any kind of consideration for use of or right to use patent, design or model, secret formula or process or for non-concerning industrial, commercial or scientific experience in addition to the use or right to use industrial, commercial or scientific equipment. The aforesaid definition is in consonance with the term 'royalty' as popularly and commercially understood. It represents consideration received by a person, who is the owner of the intangible intellectual property rights or know-how for permitting a third person to use or the right to use the said rights or know-how. It is essentially payment for a user of intellectual property right or know-how, which may be lumpsum, annual or periodical payment. The term 'royalty' is associated with the payment made for grant of the user right. Grant of user right has to be distinguished from transfer of ownership in intangible property or know-how, i.e., sale of intangible property or know-how by the proprietor to a third person. In the latter case, the consideration paid is not for use of or right to use the intangible property or know-how but to acquire full ownership. The consideration

paid for transfer of full ownership in the realm of international tax laws is normally taxed as per applicable DTAA either as capital gains or as business income. In the facts of the present case, in case we hold that the payments made by HCL to ADC were for transfer of full ownership in the know-how or intellectual properties, the same would not be taxable under Article VIIIA of DTAA, but would be taxable in the country of residence of ADC, i.e., Federal Republic of Germany, either as capital gains or as business income. However, if we hold that the payments by HCL to ADC were for mere right to use or to use intellectual property rights/know-how and not for transfer of full ownership, the said payment to ADC would be taxable in India as royalty.

8. The aforesaid legal position is well-established and the OECD commentary on Model Tax Convention, 2010, condensed version, opines:-

> "8.2 Where a payment is in consideration for the transfer of the full ownership of an element of property referred to in the definition, the payment is not in consideration "for the use of, or the right to use" that property and cannot therefore represent a royalty. As noted in paragraphs 15 and 16 below as regards software, difficulties can arise in the case of a transfer of rights that could be considered to form part of an element of property referred to in the definition where these rights are transferred in a way that is presented as an alienation. For example, this could involve the exclusive granting of all rights to an intellectual property for a limited period or all rights to the property in a limited geographical area in a transaction structured as a sale. Each case will depend on its particular facts and will need to be examined in the light of the national intellectual property law applicable to the relevant type of property and the national law rules as regards what constitutes an alienation but in general, if the payment is in consideration for the alienation of rights that constitute distinct and specific property (which is more likely in the case of geographically-limited than time limited rights), such payments are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the

payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

8.3The word "payment", used in the definition, has a very wide meaning since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom.

8.4As a guide, certain explanations are given below in order to define the scope of Article 12 in relation to that of other Articles of the Convention, as regards, in particular, the provision of information.

8.5Where information referred to in paragraph 2 is supplied or where the use or the right to use a type of property referred to in that paragraph is granted, the person who owns that information or property may agree not to supply or grant to anyone else that information or right. Payments made as consideration for such an agreement constitute payments made to secure the exclusivity of that information or an exclusive right to use that property, as the case may be. These payments being payments "of any kind received as a consideration for…… the right to use" the property "or for information", fall under the definition of royalties."

The said commentary subsequently elucidates:-

"11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 is referring to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how. The words "payments …for information concerning industrial, commercial or scientific experience" are used in the context of the transfer of certain information that has not been patented and does not generally fall within other categories of intellectual property rights. It generally corresponds to undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived. Since the definition relates to information concerning previous experience, the Article does not apply to payments for new information obtained as a result of performing services at the request of the payer.

11.1 In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to

> play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof."

9. A reading of the aforesaid quotations would exposit that the taxable event would depend upon the nature of rights acquired by the payer under a particular arrangement. In case payment is made for acquisition of a partial right in the intangible property or know-how without the transferor fully alienating as the ownership rights, the payment received would be treated as 'royalty'. Where, however, full ownership rights are alienated as intellectual property of the transferee, the payment made is not royalty, but sale consideration paid for acquisition of the intangible rights. Such acquisitions are not equivalent to acquire or have access to or right to use the intellectual property.

10. At this stage itself, we would like to draw another distinction, least there be any confusion. There can be transactions relating to intellectual properties, which may not fall in the category of absolute transfer (full ownership) or partial transfer of right to use or use of. For example, when a book is purchased from a book shop, it is treated as sale of goods. The purchaser owns the physical book, may read the book and even reap intellectual benefits, but the purchaser acquires no right in the literary or intellectual information expressed in the book. Such instances can be multifarious. However, for adjudication of these appeals, we predicate our decision on the following test; where ownership of the rights is alienated and acquired by another party, the consideration is not for use of or right to use and, therefore, not royalty and vice versa.

11. Importantly, paragraph 5 of the exchange of notes between contracting States clarifies that royalty income can consist of lumpsum consideration for transfer even made outside India or imparting of information outside India. Therefore, royalty need not be confined to

regular payments such as, yearly, quarterly or monthly or be depende... upon the quantum of production or use of the intellectual property right.

12. The aforesaid ratio is the legal position, which has been applied and accepted in several decisions in India. In ***Commissioner of Income Tax versus DCM Limited***, (2011) 336 ITR 599 (Delhi), DTAA between India and United Kingdom was applicable. DCM Limited, the assessee, had entered into an agreement with one Tate and Lyle Industries Limited, London, which envisages payment of £ 15,500 in four instalments towards supply of documents, concerning what was known as Talo processes. The UK company, a pioneer in sugar technology, was in possession of know-how for installation and operations of specialised equipment and processes and use of essential speciality chemical products, which assisted in elimination of limestone and hard coke, to greatly conserve energy and thus bring reduction in pollution and loss of sugar during manufacture. Article XIII (3) of the DTAA between India and United Kingdom defined the term 'royalty' in somewhat different manner as it was based on the OECD Model, but this to our mind would not be entirely relevant and the distinguishing factor. The Delhi High Court rejected the appeal of the Revenue in the said case after referring to the various clauses of the agreement to hold that there was absolute or full transfer of technology and know-how, albeit on non-exclusive basis, which was confined to the factories of the assessee in India and with conditional right to sub-lease, as sub-licensing of technology or know-how required consent of the UK party. The exact reasoning given by the High Court in the said case reads:-

> "8.1 In our view, it is quite clear by virtue of the aforementioned agreement what the assessee obtained was a complete transfer of technology and know-how albeit on a non exclusive basis which was confined to its factories in India with a conditional right to sub-licence it to third parties. The sub-licencing of technology and/or know-how had to have, however, the consent of Tate and

also the approval of the Government of India. The obligation of Tate to update the technology and/or know-how transferred to assessee based on research and development carried out by it, had obviously to be restricted in point of time, bearing in mind that it was a transaction which dealt with complete transfer of technology. The time span provided was 5 years from the effective date of the contract.

8.2. It was not, according to us, therefore, as contended by the learned counsel for the revenue, a mere use of the technology and/or know-how owned by Tate. Therefore, the mere fact that Tate retained with it the right to transfer technology and / or know-how to other parties did not in our view reduce the right obtained by the assessee under the agreement to one of a mere user of technology and knowhow. The transfer of technology is thus quite often, as in the present case, brought about by executing agreements which give rights far greater than a mere right to use albeit on a

non-exclusive basis. The argument made on behalf of the revenue that the transaction does not constitute a sale, misses the point that, for it to fall within the four corners of the provisions of Article XIII(3), the right conferred should be of usage; anything more than that, takes it out of ambit of definition of royalty as provided in the DTAA. We, therefore, agree with the conclusion arrived at by the Tribunal with regard to the terms of the agreement. Having come to this conclusion, it is quite obvious that the remittances made by the assessee to Tate would not fall in the definition of Article XIII(3) of the DTAA."

The said decision distinguished decisions relied upon by the counsel for the Revenue, in the following words:-

"11. In so far as the judgments cited by Mrs. Bansal are concerned, the same are distinguishable on facts. CIT Vs. J.K. Synthetics Ltd. (supra), turned on its own facts. Significantly it did not involve interpretation of the provisions of the DTAA as is the situation in the present case. Similarly, the Shri Ram case is also distinguishable. A reading of various clauses would show that there was no transfer of technology and know-how. In this regard, reference may be had to clause 11 of the agreement which specifically prohibited the right of the transferee to manufacture products based on the transferors technology after its determination. No such limitation exists in the present case. As a matter of fact, in the instant case, the termination clause provides for such an eventuality only on the grounds of insolvency of the parties. There is no general right of termination obtaining in the agreement in the present case.

> Likewise, the judgment in the case of N.V. Philips Vs. CIT (1988) 172 ITR 521 is not applicable since what was transferred was use of technology. In this regard, specific reference may be made to clause (c) appearing at page 524 which provided that any information disclosed by the assessee to the Indian company under the agreement would remain confidential and would not become the property of the Indian company until such time and to the extent that such information had "become public" by application and user. The judgment of the Supreme Court in the case of Alembic Chemical Works Co. Ltd. (supra) would also not be applicable on a similar rationale."

The decisions noted, were cases in which there was no absolute or full transfer of intellectual property rights or know-how, but only grant of right to use or permission to use intellectual property rights or know-how.

13. Having elucidated on the legal position, we would now proceed to examine the agreement between HCL and ADC styled as "Technology Transfer and Technical Assistance Agreement". With regret, that the agreement placed on record by HCL i.e. the appellant, is incomplete and also several relevant clauses are unreadable. With the assistance of the counsel, we have tried to decipher the unreadable portions. We have also taken advantage and benefit of the portions of the agreement reproduced in the order passed by the Tribunal.

14. The relevant portions of the said agreement read as under:-

> "ARTICLE 2. TRANSFERANCE AND GRANT OF RIGHTS
>
> 2.1 Subject to written approval of the appropriate government agencies and departments of the Unites States Export Licensing Authority and all conditions imposed on such approval and compliance therewith, APOLLO hereby conveys and grants to HCL the non exclusive right to manufacture, maintain, use, and sell the Licensed Products in India in accordance with pursuant to and under the Technology. Said conveyance and grant shall encompass all elements of the Technology relating to the manufacture of the Licensed Products in India which is owned by APOLLO as of the Effective Date of this Agreement.

2.2 APOLLO hereby declares that it has the unrestricted right to convey and grant to HCL the rights described in paragraph 2.1 hereof.

Sub-Licensing and Sub-Contracting

2.3 Subject to approval by the appropriate government agencies and department of the United States Export Licensing Authority and APOLLO's written consent and approval by the Government of India, HCL may sublicense or subcontract in India in whole or in part, the production of the licensed products under the Technology provided that such disclosure .....sale or leasing shall not purport to confer upon .....or subcontractor any rights other than those accorded to HCL hereunder and shall be restricted in the same manner as APOLLO disclosure of the Technology to HCL hereunder, in particular as described in the confidentiality provisions of Article 4 hereof. It is understood and agreed that HCL shall be solely responsible with any sublicensee or subcontractor for the carrying out of the provisions of this Agreement and shall guarantee payment of all consideration to APOLLO under the Agreement.

Modification/Improvement

2.4 Subject to approval by the appropriate government agencies and departments of the Unites States Export Licensing Authority and to any developments, improvements, modifications, or inventions concerning the Licensed Products made by APOLLO during the term of the agreement may become part of the Technology and may be disclosed and conveyed by APOLLO to the HCL at no additional.....in accordance with the terms and conditions of the Agreement promptly after APOLLO's use of same in its commercial manufacture of the Licensed Products.

2.5 It is understood and agreed that neither party shall be required to convey or disclose to the other party any developments, improvements, modifications, or inventions unless same are directly related to the Licensed Products, in the manner described in this Article 2.

Discontinuance of Manufacture

2.6 The parties hereby agree that APOLLO shall have the absolute right, in its' sole discretion, to discontinue the manufacture, use, sell, or otherwise do business with respect to any of the Licensed Products, at any time during the term of this Agreement and in such eventuality APOLLO shall have the discretion to eliminate said Licensed Product, from the Agreement upon such elimination from prior written notice of same to HCL. Upon such elimination herefrom,

neither APOLLO nor HCL shall have any further obligation hereunder with respect to such eliminated Licensed Product, except that notwithstanding any such discontinuance and elimination by APOLLO of any Licensed Product, APOLLO shall perform all of its obligations hereunder with respect to all the Licensed Products for a minimum period of at least two (2) years after the effective date of discontinuance. HCL shall not be precluded from continuing to manufacture, use and sell any such eliminated Licensed Products in India on the basis of the Technology already conveyed to HCL at the time of such discontinuance and elimination by APOLLO as provided, however, that HCL shall continue to comply the provisions of this Agreement.

"3.1.1 APOLLO shall deliver the tangible Technical Information constituting the Technology, in accordance with Exhibit 3 by prepaid air mail or air freight C.I.F. or by such other means which are reasonable and obtain from HCL acknowledgement of such delivery to HCL's registered office in India or to such other location in India which HCL will designate. APOLLO shall provide two (2) copies of said Technical Information in a form capable of being copied, in the English language. HCL may, at their own expense, and translate same into the Indian language, subject to the Confidentiality provisions of Article 4 hereof. APOLLO shall use all practical means to ensure that all the Technical Information under the Technology provided to HCL is accurate, comprehensive and up to date and in the event that any of the Technical Information provided is inaccurate, APOLLO shall at its own cost rectify the inaccuracy without delay. APOLLO will not be liable for any loss or damage suffered by HCL in respect of such inaccuracies.

Parties hereby recognize and agree that the tangible Technical Information referred to under Exhibit 3 herein will be transferred, from time to time, without additional lump sum payment to HCL over the duration of the agreement by the such reasonable means as and when such Technical information is required or available. Notwithstanding the above and for the purpose of payment under the Agreement under Article 6 hereof, delivery of the Technical Information constituting of items (1) to (6) under Exhibit 3 to HCL by whatever reasonable means and HCL's acknowledgement thereof shall be deemed to constitute sufficient delivery of Technology under the Agreement.

3.1.2 It is hereby expressly agreed that the Technical Transfer for the consideration set forth in article 6.2.1 is for a total of three future versions of the Licensed Products to be developed

for manufacture or marketing by APOLLO in addition to the DN 3000 series as set forth in Exhibit 2. Said Licensed Products to be Products within the product space of the first Licensed Product (to wit: DN 3000). A version is a family of engineering workstations or any significant enhancement or upgrade to said family and shall not be understood to be in any way linked to a specific product model number as used by APOLLO. For example, all products set forth in Exhibit 2 known as DN 3000 series, will constitute one version. It is further agreed that the further three versions covered under this agreement will be agreed and defined, from time to time by HCL and APOLLO and will be subject to the approval of the appropriate US Government agencies."

ARTICLE 4. CONFIDENTIALITY.

4. 1 It is understood and agreed by the parties that the Technology and any other information which APOLLO consider proprietary to itself and to its will be conveyed and disclosed by APOLLO to HCL in carrying out the provisions of this Agreement is and shall remain confidential during the terms of this Agreement and after the expiration or termination thereof for any reason whatsoever, until such time as same shall enter the public domain or otherwise become generally known without any material breach of this Agreement by HCL.

4.2 HCL agrees that they shall maintain the confidentiality of the Technology and said other information conveyed and disclosed by APOLLO hereunder and shall not without prior written consent of APOLLO, disclose same or allow same to be disclosed to anyone, except to their management and employees and to any of HCL's sub-licensee (s), subcontractor(s), agents or suppliers and then only to the extent required for the proper and authorized use of the Technology hereunder, unless the Technology and said other information;

(a) are contained at the time of disclosure by APOLLO hereunder or thereafter in a patent or patent application or other printed publication made by a third party without any breach of this Agreement by HCL; or

b) are acquired by HCL from a third party lawfully in possession of same and not subject to any contractual fiduciary obligation to APOLLO to maintain the secrecy of same. HCL agree that, prior to any disclosure of the Technology and said other information, they shall enter

into confidentiality agreement, containing in substance the provisions of this Article 4, with their management and employees and with any of the HCL's sub-licensee(s) subcontractor(s), agents or suppliers to whom such disclosure is to be made.

4.3 HCL agree that any reproductions, notes, summaries, conversions, translations, or similar documents containing or relating to the Technology shall themselves become immediately upon their creation, a part of the Technology and, thus, subject to the confidentiality provisions of this Article 4.

4.4 The parties hereby agree that they shall keep secret and confidential and shall appropriately safeguard and not disclose to any unauthorized person, during the term of this Agreement and after the expiration or termination hereof for any reason whatsoever, all secret and confidential information which they may acquire pursuant to this Agreement in relation to any other party or any part of its business.

ARTICLE 5. INDUSTRIAL PROPERTY RIGHTS, WARRANTIES AND QUALITY CONTROL.

5.1 HCL shall not at any time or in any manner question, content or dispute the right, title, interest of APOLLO, and its Licensors in and to, or the validity of, any of the patents, patent applications, un-patented inventions, or other industrial property rights including but not limited to any registered or unregistered trade mark or trade names and copyright of APOLLO and its Licensor covering the Licensed Products and constituting the Technology, and shall not aid or encourage others to do so.

5.2 APOLLO hereby declares that, to the best of its knowledge the rights, of any third parties will not be infringed by the parties performance of this Agreement and by HCL's use of the Technology, to manufacture, use, sale and maintenance of the Licensed Products by HCL under this Agreement. APOLLO makes no representation or warranty, implied or otherwise, as to whether the Technology conveyed hereunder to HCL and embodied in the Licensed Products, the methods of manufacture the licensed products, the methods of or the maintenance and sale of the Licensed Products in India will infringe the industrial property rights or any other rights of any third party.

5.3 In the event of any suit or threatened suit or claim against HCL by any third party for infringement of

industrial property rights or any other rights resulting from the manufacture, use, sale or maintenance of the Licensed Products, HCL shall forthwith, upon receiving knowledge thereof, give written notice of any such suit or threatened suit to APOLLO and APOLLO shall make available to HCL all relevant information, evidence, and particulars in APPOLLO's possession which may assist HCL in defending or otherwise dealing with such suit or threatened suit.

5.4 It is understood and agreed by the parties that HCL may be granted the right in India to enforce, or to enjoin or to recover damages on behalf of APOLLO for the infringement of, any patent registered or non-registered trademark or trade name or copyright of APOLLO and its' Licensors concerning the Licensed Products which is conveyed to H L hereunder.

5.5 HCL shall advise and submit to APOLLO a copy of each patent application or patent renewal covering any development, improvement, modification, or invention applicable to any of the Licensed Products described in paragraphs 5.5 and 5.6 hereof, which is filed or acquired by HCL in India during the term of this Agreement by written notice to APOLLO within thirty (30) days after any such filing or acquisition. On HCL filing such patent application or patent renewal shall file a correspondent patent application or patent renewal in any country specified by APOLLO at APOLLO'S written request and expense. HCL shall advise the APOLLO for any issuance or acquisition during the term of this Agreement of any patent covering any such development, improvement, modification, or invention by written notice to HCL within thirty (30) days after any such issuance or acquisition.

5.6 This Agreement shall remain in full force and effect regardless of whether APOLLO shall at any time own or

control patents in India covering the Licensed Products. As at the Effective Date of this Agreement APOLLO has no application pending or otherwise or any existing patent registered in India. APOLLO and/or its' Licensors "shall, however, have the exclusive right to file any patent applications in India relevant to the Licensed Products. Any patents which may be granted to APOLLO and/or its Licensors in India with respect to the Licensed Products during the term of this Agreement shall be considered part of the Technology and shall be promptly conveyed to the HCL in accordance with the terms and conditions of this Agreement.

5.7 Any patents principally which may be granted to the HCL outside India with respect to the Licensed Products during the term of this Agreement shall be licensed to APOLLO and/or its Licensors outside India on an exclusive basis (other than for HCL themselves) and at no charge to APOLLO, except for the royalty which must be paid by a licensee to the inventor of patent as a matter of Indian law.

Quality Control

5.8 APOLLO represents that the Technology to be conveyed to HCL hereunder shall be the same Technology on the basis of which APOLLO itself manufactures the Licensed Products and that the Technology, together with the Technical Assistance to be furnished to the HCL hereunder, 'shall by sufficient for the manufacture of the Licensed Products. Therefore, HCL utilising the Technology and the Technical Assistance, should, be able to manufacture the Licensed Products with the same quality as those manufactured by APOLLO. Subject to any approval by the relevant agencies, and department of the U.S. Export Licensing Authorities APOLLO agrees to provide additional Technology, if same is available to APOLLO, and Technical -Assistance to clarify the Technology, if requested by HCL, to facilitate HCL's achieving the standard of quality of the Licensed Products contained in the Technology, at a cost to HCL to be mutually agreed upon by the parties. However, nothing containing in this Agreement shall be construed' as a warranty by APOLLO that HCL, will in fact be able to manufacture the Licensed Products at the level of quality or in the quantities or with the efficiencies as those of APOLLO.

5.9 HCL shall use its' best efforts to maintain a standard of quality and workmanship in its' manufacture of the Licensed Products equal to that of APOLLO and shall manufacture the Licensed Products out of materials supplied by parties to be mutually agreed between HCL and APOLLO. HCL shall permit representatives of APOLLO, upon reasonable advance notice and during normal business hours, to inspect the manufacturing facilities of HCL used for the manufacture of the Licensed Products. In particular, APOLLO'S representative shall be permitted to inspect and monitor the quality control procedures to be used by HCL, as well as to inspect samples of the Licensed products and the compliance by HCL, with the quality standards for the Licensed Products contained in the Teohnology.

Trademarks

5.10 ……..

ARTICLE 14. DURATION AND TERMINATION

14.1 Unless earlier terminated, this Agreement shall have an initial term of five (5) years commencing on the effective Date hereof. In the event that this Agreement is not terminated earlier than said full initial term, then HCL may thereafter continue to manufacture, use and sell the Licensed Products under the rights granted herein without the obligation of paying any additional consideration to APOLLO, including the right to manufacture, use, and sell under any patents included in the Technology covering the Licensed Products, provided that HCL shall make no claims a against APOLLO with respect to the Licensed Products.

TERMINATION

14.2 This Agreement shall terminate prior to the expiration of the initial term described in paragraph 1 hereof, whenever any of the following events occur:

(a) the terms and conditions of this Agreement are materially breached by either party and said material breach is not cured within ninety (90) days from the receipt by the breaching party of written notice of such breach from the non-breaching party; or

(b) In the event that either party be adjudged insolvent or bankrupt, or upon the institution of any proceedings by or against it seeking relief, reorganization or arrangement under any laws relating to insolvency, or upon any assignment for the benefit of creditors, or upon the appointment of a Receiver, Liquidator or Trustee of any of its' property or assets, or upon the liquidation, dissolution or winding up forthwith be terminated *or* cancelled by the other party hereto.

14.3 The early termination of this Agreement for any reason shall not affect any accrued rights or obligations of the parties as of the effective date of such termination, nor shall it affect any rights or obligations of the parties under this Agreement which are intended by the parties and agreed herein by them to survive any such termination, especially the secrecy provisions of Article 4 hereof, nor shall it preclude any claim for damages or other remedy of the party effecting such early termination against the other party hereto.

14.4 The HCL agrees that, upon the early termination of this Agreement attributable to material breach by HCL:

(a) All rights granted hereunder shall revert to APOLLO;

(b) HCL, its sublicensee(s) and subcontractor(s) shall cease to use the Technology and to manufacture, use, and sell the Licensed Products and;

(c) the HCL shall forthwith deliver to APOLLO (or its' designated subsidiary or affiliated corporation)all original and copies materials embodying the Technology (either in their original form or in a form translated into another language) including but not limited to the Technical Information under Article 3.1 or at the request of APOLLO shall destroy the same."

15. On examination of the aforesaid clauses, we have to determine whether it was a case of full transfer of ownership or ADC had merely permitted use of or right to use intellectual properties or know-how to HCL. The first portion of the agreement records that ADC and its licensors were engaged since 1980 in development, design, manufacture and sale and maintenance of computers used in engineering, scientific or technical applications and had acquired confidential and valuable proprietary rights in technical data and know-how relating to manufacture, testing and maintenance of such computers. HCL had desired to obtain technical data and know-how relating to licensed products described in Exhibit 3 (a paper/document not filed) and to manufacture, sale and maintain the said licensed products in India. ADC was to provide on mutually agreeable terms marketing, sales and technical support and to train HCL develop local system builders and software programmes and equipment i.e. the hardware. The term technology meant ADC's confidential and proprietary technical information, technical data, know-how, drawings, designs, processes, etc. Details of licensed products mentioned in Exhibit 3 are not available as the said exhibit has not been filed on record.

16. Article 2 is important and has been misquoted in the impugned order by the Tribunal as also in the grounds of appeal. What was granted and

conveyed to HCL was non-exclusive right to manufacture, maintain, use and sell the licensed products in India in accordance with and pursuant to use of the technology. In the impugned order, clause 2.1 has been quoted as if an exclusive right was granted to the HCL, an assertion which is also made in the grounds of appeals. Albeit, it was accepted during the course of arguments that HCL was granted non-exclusive right by ADC and not an exclusive right. ADC had agreed to convey such technical data and know-how and grant to HCL non-exclusive right to manufacture, sell etc. the licenced products in India only pursuant to and for applying the technology. Clause 2.3 is important and stipulated that HCL could sub-licence or sub-contract in India in whole or in part production facilities of the licensed products under the technology and could disclose the said technology to the sub-licensee or sub-contractor, provided that such disclosure would not confer on the sub-licensee or the sub-contractors any right other than those granted to HCL and shall be subjected to restrictions and confidentiality provisions of Article 4. Clause 2.4 stipulated that subject to necessary approvals, ADC would also convey to HCL improvements, modification or inventions relating to the licensed products during the term of the agreement, which shall become a part of the technology. Thus the rights granted to HCL by ADC were restricted to specified and listed licensed property. Clause 2.6 stipulated that ADC had the absolute rights in its own discretion to discontinue and eliminate manufacture, use of, sale or otherwise stop business in respect of licensed products at any time during the term of the agreement. Notwithstanding, such dis-continuance/elimination, ADC would perform all obligations for a period of two years after the effective date of discontinuance. HCL could continue to manufacture, use and sell such eliminated licenced products, subject to HCL complying with provisions of the agreement. Article 3 dealt

with delivering of tangible technical information (2 copies) to be provided by ADC to HCL in English language. The technical information and technology was required to be accurate, comprehensive and up to date. In case of any inaccuracy, ADC at his own cost was required to rectify inaccuracy without delay, but was not liable for loss or damage caused to HCL due to such inaccuracies. This was subject to confidentiality provisions of Article 4. Further, tangible technical information relating to in Exhibit 3 (a document not filed) was required to be furnished to HCL from time to time during the term of the agreement without any additional lumpsum payment. Thus, upgradation of tangible technical information was stipulated. Clause 3.1.2 stipulated that a total three future versions of the licensed product, to be developed and manufacture by ADC in addition to the DN 3000 series as set forth in Exhibit 2, would be furnished. The products were not to be specifically developed for HCL.

17. Article 4 stated that the technology and other information would be considered as a propriety of ADC and its licensors and what was conveyed and disclosed by ADC to HCL would remain confidential during the term of the agreement or after expiration or termination thereof till the said technology and other information entered public domain or was otherwise generally known. HCL was to maintain the confidentiality of technology or other information. Without prior written consent of ADC, HCL was barred and prohibited from making disclosure, except to its management and employees or its sub-licensee/contractor to the extent required for proper and authorised use of technology. The confidentiality and secrecy was to be appropriately safe guarded and not disclosed to an unauthorised person during and even after the expiration or termination of the agreement.

18. Article 5 stated that the HCL would not at any time or in any manner question, contest or dispute ADC's patent, patent application, unpatented inventions or industrial property rights and would not encourage or aid others to do so. In the event a third party filed a suit or threatened to file a suit for infringement of industrial property, HCL was required to inform ADC and make all relevant information, evidence, etc. available to ADC. ADC was obliged to make available to HCL all information, evidence and particulars in their possession to them to defend or deal with said suit or threatened suit. The said stipulations were regarding defending a suit or threatened suit. It further stipulated that the HCL could be granted right in India to enforce, enjoin or recover damages on behalf of the ADC for infringement of any registered patent, non-registered trademark etc. regarding licensed products conveyed to HCL. HCL was advised to submit to ADC, copy of patent application or renewal in respect of the licensed products, which was filed or acquired by HCL in India within 30 days of such filing or acquisition. HCL on filing of such patent application or to obtain renewals was required to file corresponding patent application or renewal application at ADC's written request and expense.

19. The agreement was to remain in full force and affect, whether ADC had at any time owned or controlled patents in India covering the licensed products. ADC or its licensors had exclusive right to file any patent application in India relevant to the licensed products and any patent, granted to ADC or its offices in India with respect to the licensed products during the term of the agreement were considered to be a part of the technology and were to be promptly conveyed to HCL. Clauses 5.8 and 5.9 dealt with quality control and ADC's right to ensure quality of licensed manufactured products. HCL was required to maintain standard quality and workmanship of the licensed products equal to that of ADC. ADC by

giving reasonable advance notice and during the normal business hours could inspect the manufacturing facilities of HCL used for manufacture of licensed products. Under clause 1.12, HCL had agreed appointment of an administrative agent by ADC to ensure compliance of obligations by HCL.

20. Article 6 dealt with consideration and in respect of technology conveyed or technical information or assistance to be provided under Article 3.1, lumpsum consideration of US$ 1.1 million free of Indian tax, was payable. The tax, if payable, was to be paid by HCL. Fixed royalty of US$ 800 for each licensed product manufactured, sold or leased by HCL was to be paid. Similarly, royalty for software programs @ US $ 700 per software was payable. Royalty was also payable for reproduction of documentation @ US$ 6 per copy.

21. At this stage, we may clarify that in this appeal we are only concerned with the lumpsum consideration of US$ 1.5 million payable for technology conveyed, technical information and technical assistance to be provided under Article 3.1. We are not concerned with the royalty of US$ 800, US$ 700 and US$ 6 per copy under sub-clause (ii) and (iii) of Article 6. On the said amounts, it appears and it was stated at the Bar on behalf of the appellant-HCL that payments were treated as royalty under Article VIIIA of the DTAA and these stand subjected to tax in India.

22. Article 14(1) stipulated that the initial term of the agreement was 5 years commencing from effective date and in case the agreement was not terminated earlier, HCL could after the termination continue to manufacture, use or sell the licenced products under the rights granted therein, without obligation to pay additional consideration to ADC provided HCL did not make any claim against them in respect of the

licensed products. The agreement could be terminated as on the stipulations stated in clause 14.2.

23. Clause/Article 14.3 of the agreement in clear terms records that earlier termination would not affect accrued rights and obligations effective on the date of termination nor shall it affect the obligations or rights of the parties under the agreement. Specific reference is made to the secrecy and confidential provision contained in clause/article 4. Thus, irrespective of earlier termination, the confidential or secrecy provision would continue to apply. In categorical terms, it is specified that claim for damages or remedy would not be barred or affected because of earlier termination against either party. In clause/article 14.4, HCL agreed that upon earlier termination of this agreement attributable to material breach on the part of the HCL, all rights granted to them shall revert to ADC and the sub-licencees and sub-contractors of HCL shall cease to use technology, manufacture, and use or sell the licenced products. Lastly, HCL shall forthwith deliver to ADC the tangible material in the form of original copies embodying the technology including but not limited to technical information under Article 31 or at the request of the ADC, destroy the same.

24. Having considered various clauses of the agreement, we do not think the present case is one of absolute or full transfer of ownership in technology made available under Article 3 of the agreement. The proprietorship or ownership rights continued to vest with ADC, but right to use with trade name, technology etc. was granted by ADC to HCL. There was no transfer of the ownership in the intellectual property rights. In fact, the agreement stipulated that the HCL could protect the patents and intellectual property rights of ADC. The manufacturing and other

activities undertaken by HCL was subject to quality control and inspection by ADC. Clause 4.1 clearly stipulated that technical and other information was to remain ADC's proprietary. Information/knowhow was to remain confidential during the term of the agreement and even after expiry or termination thereof, until the same entered public domain or was otherwise generally known. HCL could not have breached the said confidentiality clause. A material breach by HCL would have resulted in an earlier termination of the agreement and reversion of all rights granted to HCL. It entailed ceasure of right to manufacture, use or sell the licensed products. Tangible technical information was to be returned. The agreement permitted HCL to disclose the said confidential intellectual property rights to the sub-contractors or sub-licensees only to the extent required for proper and authorised use of technology. Clause 2.3 was similarly worded and stated that HCL might sub-licence or sub-contract in whole or in part production of the licensed products and might disclose the technology provided that such disclosure would not confer upon the sub-contractor or the sub-licencee any rights other than those accorded to HCL. In case HCL was conferred full or absolute ownership in the intellectual property rights or in know-how, then it should follow as a sequitur that HCL was competent to transfer or convey to the sub-contractors and sub-licencees intellectual property rights. Clause 2.3 specifically refers to the confidentiality clause in article 4 and the binding effect. The clause relating to further technology or information in addition to technology already transferred is illustrative that it was not a case of complete or full transfer, but only a case of right to use or permission to use the technology by HCL. Thus, the provision for upgradation. The stipulation also reflects acceptance and recognition that the technology in the said field was transient and transitory and not lasting. Developments and improvements

were rapid, widespread and vigorous. Constant upgradation and improvements were eminent and rule of business.

25. Dias in his work "Jurisprudence" has defined "ownership" as an interest recognize by law, which consists of innumerable number of claims, privileges, powers and immunities with regard to the thing owned. Ownership, therefore, is a bundle of rights, which a person who has title over the property, enjoys and commands. Holland, T.E. in Element of Jurisprudence observed that rights of ownership, conventionally could be arranged under three heads i.e. possession, enjoyment and dispossession. Right of dispossession carries with it right of alienation or destruction. Alienation may be either total when the ownership itself is transferred; or may be partial when a fraction of the rights, is granted or permitted. In cases of immoveable properties, the owner can grant right to use in the form of lease to a third person without transferring the ownership. Similarly, in cases of moveable properties, the owner may grant a license to use. For example, a contract for hire or by way of hire in a contract of bailment. The hirer obtains a right to use the chattel hired in return of payment to the owner for the price of hiring. The proprietary interest in the chattle does not change and remains with the owner, though upon delivery of the chattle, the hirer becomes legally possessed. If the hiring is for a particular time, the true owner may be barred during that time from resuming possession against hirer's will and, should he do so, the owner would liable for damages for wrongful seizure.

26. Intellectual property is a property in legal sense i.e. it can be dealt with and owned under common law or statutory provisions like rights associated and analogous with ownership of tangible property. Legal theorist Hohfeld has exposited that every right has associated duty-there cannot be one without the other. In case of Intellectual property rights, the

owner would have right of enjoyment, use and dispossession; absolute or partial. The co-related duty owed by third parties, would be not to infringe the said rights, unless permitted and allowed by law as in the case of fair dealing provisions.

27. David Bainbridge in Intellectual Property, Third Edition in Chapter-Introduction at page 10 has observed that most forms of intellectual property are 'choses in action'; rights that are enforced only by legal action as opposed to possessory rights. Quoting from an earlier decision in ***Torkington Vs. Magee*** (1902) 2KB 427, it stand elucidated that the expression 'choses in action' is used to describe all personal rights which can be enforced by action and not by taking physical possession.

28. Intellectual property rights are intangible as their subject matter emanates from human intellect. They could be treated as partially tangible when documented. Intellectual property rights can be dealt with like both movable and immoveable property, for it can be assigned/transferred, mortgaged or licensed. Transfer of intellectual property rights by way of sale or assignment when complete or absolute, results in exclusive rights being conferred on the transferee or the assignee, who becomes the new owner and is entitled to exercise all rights as an owner. The owner, however, need not transfer complete ownership and can grant a license or permission to use to a third party, one or more acts. The license granted amounts to permission to use, the intellectual property rights. The rights conferred on the licensee may vary. The right to use may be in respect of a single act, restricted to a location or for a limited period of time or duration. It may be a one-time act or there can be stipulations as to upgradation or right to access future technological advances. One of the important attributes of intellectual property rights in cases of technology, patent etc. is confidentiality. It is confidentiality, which gives the owner

the commercial edge, competitive position and superiority. Confidentiality enforces monopoly. Confidentiality and monopoly are the most valuable rights which the owner possesses and commercially exploits. License to use know-how or technology is, therefore, and often given with riders and condition to maintain confidentiality to ensure that the valuable asset of the licensor is preserved and secured. Thus, the owner can grant a trail of licenses to third parties with identical or similar limited rights of use with the confidentiality clause and without assignment or transfer of ownership. The price agreed, between the licensor and the licensee for right to use, could depend upon several factors. The commitment by the licensee not to disclose the know-how or technology to third parties, except under certain conditions or with the consent of the licensor, being one of the foremost factors. A license is personally and generally would not be transferable or assignable. A licensee, who has granted right to use cannot sue on his own name, without making the licensor a party, whereas an assignee/transferee can sue for infringement without joining the assignor.

29. Transfer results in vesting of title, but a license only grants right to do something. Sometimes, it may be difficult to differentiate whether it is a case of mere grant of right to use or a case of assignment or transfer. When such questions arise, substance take precedence over the form.

30. We have already quoted the relevant portions of decision in the case of ***DCM Limited*** (supra) that the DCM's restricted/curtailed right to transfer technology or know-how to other parties, would not reduce the right of DCM Limited under the agreement to mere use of technology and know-how. We have also not based our decision on reading that what was conveyed to HCL was a non-exclusive right. Yet it cannot be denied that these with others conditions are relevant criteria or factors, which we

should examine to ascertain the nature and character of the right acquired. Commutative effect of all clauses must be given effect to. We do not think that observations in paragraph 8.2 in ***DCM Limited*** (supra), to the effect that royalty or right of usages must be only conferred and anything more than that would not be 'royalty', is contrary to what we have held above. The aforesaid observations have to be read in light of what has been stated in paragraph 8.1 and then in paragraph 11 of the said judgment. Appropriate in this regard would be to reproduce Klaus Vogel on *Double Taxation Conventions* on the said question, which reads:-

> "A distinction must be made between letting the licensed asset for use on the one hand and transferring its substance by alienation (regarding the deviation of US MC, see infra m. no. 63). The decisive difference in this connection is the degree of change in the attribution of the asset from licensor to licensee. On the other hand, another distinction to be made is letting the proprietory right, experience, etc., on the one hand and use of it by the licensor himself, e.g., within the framework of an advisory activity. Within the range from 'services', via 'letting' to 'alienation', outright alienation is the one clear-cut extreme, viz. outright transfer of the asset involved (right, etc.) to the payer of the royalty. The other, just as clear-cut extreme is the exercise by the payee of activities in the service of the payer, activities for which the payee uses his own proprietary rights, know-how, etc., while not letting or transferring them to the payer (for more details regarding the distinction between licensing and the provision of services, see infra m.nos. 54ff., in connection with the various subjects of licences). Neither extreme comes under Art. 12, all that does is the central category, viz. 'letting'."

31. This is indeed the true and appropriate test, which has to be applied. Paragraph 11 ***DCM Limited*** (supra) specifically makes reference to the decision of the Calcutta High Court in ***N.V. Philips versus Commissioner of Income Tax (No. 1)***, (1988) 172 ITR 521 and it was held that the said decision was related to transfer or use of technology as it provided that the information disclosed under the agreement would remain confidential and would not become property of the Indian company till such time and to

such extent the information became public by application or user. Similar clause as quoted above exists in the present case also. In ***N.V. Philips*** (supra), Shyamal Kumar Sen, J. while concurring with the judgment of the Dipak Kumar Sen, J. held as under:-

> "While agreeing with my learned brother, I wish to add the following :
>
> The facts that the company would keep all information received from the assessee solely for the purpose of its use in its factory and would treat the same as having been disclosed in confidence and that it shall not become the property of the company until such time as and to the extent that such information or any part thereof becomes public. As a result, the user or disclosure really shows that the assessee treated the said processes and information as its own exclusive property and did not part with the same except on the above restriction. The analogy of a teacher in parting with his knowledge to the pupil cannot have any application because the teacher does not impose such restriction. It has been expressly provided in that agreement that the company agreed that it would take all reasonable care to keep such information confidential and not to disclose the same to any third parties and it only shows that this is in the nature of an exclusive right or property of the non-resident assessee and permission was granted only to utilise the same for its own specific use in a particular manner by the Indian company. It was further provided that the Indian company would not copy the equipment, tools and instruments or any part thereof supplied by the assessee to the company nor would cause or permit the same to be copied.
>
> Although no licence has been granted by the owner of a patent in this case, this is analogous to the position of a patent-owner granting a licence because this is really a permission granted to use the secret process exclusively in a particular manner and it is meant only for the Indian company and not to be disclosed to any third parties. Therefore, it is clear that the non-resident assessee itself treated the method of manufacturing process carried on by it as its exclusive secret process over which it had exclusive domain and wanted the same to be kept a secret and not meant for the public and granted the company right to utilise the same only in the aforesaid restricted manner. This secret knowledge in this case is as much its capital asset as is a patent, a monopoly and a capital asset of the patentee as observed by Romer L.J. in the case of Handley Page [1935] 19

> TC 328. This secret process which the non-resident assessee-company is parting with in this case is analogous to the parting of a monopoly right of the patentee and, therefore, the remuneration received by the assessee for the same should be treated as royalty and for the reasons as aforesaid, the answer to the question referred should be in the affirmative and in favour of the Revenue."

32. In ***Shriram Pistons and Rings Limited versus Commissioner of Income Tax***, (2008) 307 ITR 363 (Delhi) a clear distinction was made between outright sale and a right to use and the effect thereof. Reference was made to the decision of the Supreme Court in ***CIT versus Ciba India Limited***, (1968) 69 ITR 692 (SC) to the effect that the technology agreement was to remain in force for a period of five years and there was a provision for earlier termination and Indian company could not have assigned the benefits and obligations without taking consent of the foreign party. What had been acquired by the Indian company was mere access to the technical information and experience in the pharmaceutical field and the licence granted was for a limited period for running of business. There was no attempt on the part of the foreign party to part with technical knowledge absolutely in favour of the Indian assessee as the said secret processes were not sold, but right to use was granted for a limited time. Reference was made to the decision of this Court in ***Triveni Engineering Works Limited versus Commissioner of Income Tax,*** (1982) 136 ITR 340 (Del.) to draw a distinction between outright sale and supply of technical information and details with the copyright and the intellectual property rights remaining with the foreign company. In the said case, agreement was valid for ten years, but could be terminated earlier and was limited to India. The agreement stipulated that documents, dies etc. were to be absolute property of the Indian assessee, yet the copyright remain vested with the foreign company and the assessee has been given licence to use

the same during the agreement. Complete confidentiality was postulated. In the said case, it was held that the licensee had acquired merely right to use and mention of the word 'sold' in the agreement would not undo the real effect that there was no sale of technical know-how and the assessee's rights were hedged with all sort of conditions.

33. No doubt, the agreement in the present case refers to the tenure of five years unless it is terminated earlier, but the confidentiality obligation subsists and would be applicable even subsequently. It does not matter that no lumpsum payment or periodical payments were required to be made after five years, if what was conferred and granted to HCL was mere right to use or permission to use the intellectual rights and knowhow. As noticed above, lump-sum payments are covered under the term 'royalty'. The agreement postulated grant of permission to use or right to use intellectual property rights or knowhow and it is not a case of outright sale. Mode and manner is not determinative, but nature and character of the right acquired is definitive and decisive criteria.

34. The period of five years cannot be read in isolation and would necessarily have reference to the commercial life of the intellectual property rights for which permission or right was granted. Repeatedly it has been held that intellectual property rights in scientific processes, technology etc. have limited time scale benefit and have invariably a short life span, due to rapid progress and advancement in such fields. In ***Alembic Chemicals Works Co. Ltd. vs. CIT*** (1989) 177 ITR 377 (SC) with reference to rapid advances and research in micro biology, it was observed that it would not be correct to attribute a degree of durability and

permanence to technical knowhow in medical sciences. The same principle would be equally applicable, as it has not been shown or indicated that the right to use technology had an enduring or long term commercial benefit. The clause relating to upgradation, elimination and discontinuance of manufacture by ADC, reflects the fleeting and momentary life span of the technical information. In *Alembic chemical (supra)* elucidating the said facets, it was held that acquisition in such fields with rapid and fast strides indicate grant of right to use of knowhow, rather than ownership acquisition. This aspect, when read cumulatively with restrictions on the right of the assessee in dealing with knowhow and conditions as to non-partibility, confidentiality and secrecy, reference to intellectual property rights of ADC and their protection, reflect and re-enforce our finding. ADC continued and remained the owner. The appellant HCL was only granted a right to use.

35. In ***CIT vs. Devi Ashmore India*** (1991) 190 ITR 626 (Cal.), it was observed that the non-resident had not retained the property in the design and the drawings and it was out and out transfer or sale of the said design or drawing. Therefore, it was not a case of royalty but consideration for sale. The said decision is therefore distinguishable. In the case of ***Citizen Watch Company Limited versus Inspecting Assistant Commissioner***, (1983) 15 Taxman 438 (Karnataka) on facts it was held that the payment made was not royalty.

36. The counsel for the appellant HCL had placed before us two comparative charts to show a similarity between the clauses of the agreement in ***DCM Ltd.*** (supra) and in the present case. However, we do not find adequate and sufficient similarity. In ***DCM Ltd.*** (supra), an agreement envisaged a transfer of comprehensive technical knowhow

which included of trade secrets, technical information – tangible and intangible including documents, process description, process flow diagrams and it was a case of full transfer of rights but in the form of non - transferable licence to practice the 'TALO' processes in the assessee's existing factories with a right to sub-licence the rights to any other Indian party provided the terms and conditions of sub-licences were previously agreed by the foreign party also. It was a case of transfer of full rights, though even after transfer Indian assessee could not have further transferred the same except with express consent. Reference must be made to nature and type of technical information transferred and its life span in commercial sense. There are other distinguishing features which we have dealt with and noticed above to hold that HCL Ltd. was only permitted and allowed use and right to use. Absolute and complete transfer is clearly missing in the present case.

37. In view of the aforesaid discussion, the substantial questions of law mentioned above are answered against the appellant assessee and in favour of the respondent Revenue. The appeal is accordingly disposed of. In the facts of the case, there will be no order as to costs.

(SANJIV KHANNA)
JUDGE

(V. KAMESWAR RAO)
JUDGE

February 03rd, 2015
VKR/NA/kkb