



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

Date of Decision: 24.11.2020

+ ITA 1388/2018

THE COMMISSIONER OF INCOME TAX - INTERNATIONAL
TAXATION - 2Appellant

Through: Mr. Kunal Sharma, Senior
Standing Counsel with
Ms. Zehra Khan, Advocate.

versus

MICRO FOCUS LTDRespondent

Through: Mr. G C Srivastava and
Mr. Suvinay K Dash,
Advocates.

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THE COMMISSIONER OF INCOME TAX - INTERNATIONAL
TAXATION - 2 ...Appellant

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versus

MICRO FOCUS LTD ...Respondent

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Mr. Suvinay K Dash,
Advocates.

CORAM:

HON'BLE MR. JUSTICE MANMOHAN

HON'BLE MR. JUSTICE SANJEEV NARULA

SANJEEV NARULA, J. (Oral)



1. The present appeals under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') are directed against the common order dated 17.05.2018 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the 'ITAT') allowing inter *alia* ITA No. 2377/DEL/2016 for AY 2010-11 and ITA No. 177/DEL/2017 for AY 2013-14, filed by the Respondent-Assessee.

2. The Appellant-Revenue urges the following substantial questions of law:

2.1 Whether on the facts and circumstances of the case and in law, ld. ITAT erred in holding that receipts of the assessee from sale of software is not taxable as royalty under the India -UK DTAA?

2.2 Whether on the facts and circumstances of the case and in law, the ld. ITAT was right in holding that explanation 4 to section 9(1)(vi) of the I.T. Act, 1961, would not apply to India - UK DTAA without considering the fact that the explanation 4 is reiteration of legislature view already expressed in Circular No.588 dated 02.01.1991 and circular No. 621 dated 19th December, 1991 which were issued prior to entry into force of India - UK DTAA?

2.3 Whether ld. ITAT erred in not holding receipt of assessee as royalty though as per section 14(b)(ii) of India copyright Act selling or giving on commercial rent any copy of computer programme is copyright?

2.4 Whether ld. ITA T erred in not appreciating that receipts by the assessee is ultimately due to use of software by end users and end users use the software only as licensee?

3. The factual background in the afore-noted appeals is similar and both the appeals raise identical questions of law for determination by this Court and accordingly the same are being decided by way of this common order.



4. Briefly stated the facts of the are that Micro Focus Ltd. (hereinafter referred to as the 'Respondent-Assessee') is a company incorporated in UK and is engaged in the business of development and distribution of software products. It sells software products in India, either through its distributors or directly to the customers. The Respondent-Assessee enters into contracts with its customers on principal-to-principal basis and sale of software licenses is concluded outside India (offshore supplies). For AY 2010-11, the Respondent-Assessee did not file its return of income. For AY 2013-14, the return of income was filed declaring nil income. In respect of AY 2010-11, reassessment proceedings under Section 147/148 of the Act were initiated and notice under Section 148 was issued and served upon the Respondent-Assessee. In response to the notice, Respondent-Assessee filed its return declaring nil income. In respect of AY 2013-14, the case was selected for scrutiny and notice under Section 142 (1) was issued and was served on the Respondent-Assessee. In respect of both the years in question, draft assessment orders under Section 144C (1) were framed by the Assessing Officer ('AO'). Aggrieved by the same, the Respondent-Assessee filed its objections before the Dispute Resolution Panel ('DRP'). Vide separate orders for each of the wo years, the DRP disposed of the objections of the Respondent-Assessee and confirmed the stand taken by the AO. Pursuant to the draft assessment, the final assessment under Section 144C(3) read with Section 143(3)/147 was framed by the AO wherein it was noted that the Respondent-Assessee had entered into a contract with a few Indian distributors/customers from whom the Respondent-Assessee was in receipt of income on which the TDS was also deducted by the distributors/customers. Accordingly, it was held by the AO that the receipt of income from the sale of software products in India is taxable under the head 'Royalty' as per the provisions of Section 9(1)(vi) of the



Act read with Article 13 of the India-UK Double Taxation Avoidance Agreement (hereinafter referred to as 'the DTAA'). Consequently, the AO determined the income by holding the receipts of the Respondent-Assessee as its royalty income and taxed the same at 10%.

5. Aggrieved by the aforesaid order, the Respondent-Assessee filed an appeal before the learned ITAT. The learned ITAT after considering the facts and circumstances of the case, allowed the appeals in favour of the Respondent-Assessee, *inter-alia* observing as under;

"8. Thus, the issue relating to the consideration received by the assessee from various entities on account of sale of software is not royalty within the meaning of Article 13 of the India UK DTAA, the effect of Article 3(2) of DTAA clearly set out the definition of royalty as per the distributor agreement and the end user license agreement which was produced before the Assessing Officer as well as before the CIT(A). The DRP has not taken into account the correct and true meaning of the royalty and the services do not come under the purview of royalty. The Hon'ble High Court in case of Principal CIT Vs. M Tech India Pvt. Ltd. vide order dated 19/1/2016 has held that payment made by reseller for the purchase of software for sale in Indian market could not be considered as royalty. IT is observed and held that amendments cannot be read retrospectively in consonance with the treaty."

6. The Appellant-Revenue is aggrieved by the aforesaid order and has preferred the present appeals.

7. We have heard Mr. Kunal Sharma, learned Senior Standing Counsel appearing on behalf of the Appellant-Revenue, at considerable length. Mr. Kunal Sharma argued that the learned ITAT has erred in holding that receipt of the Respondent-Assessee from the sale of software is not taxable as royalty under the DTAA. He also argued that the learned ITAT has erred in



holding that Explanation 4 to Section 9(1)(vi) of the Act would not apply to the DTAA. The learned ITAT has failed to consider that Explanation 4 is a reiteration of the legislative view already expressed in Circular No. 588 dated 02.01.1991 and Circular No. 621 dated 19.12.1991 which were issued prior to the coming into force of the DTAA. He further argued that the learned ITAT has erred in not holding the receipt of Respondent-Assessee as royalty, contrary to Section 14(b)(ii) of the Copyright Act, 1957 which stipulates that selling or giving on commercial rent, any copy of a computer programme is copyright.

8. We notice that the learned ITAT has decided the appeals in favour of the Respondent-Assessee on the basis of the decision of this Court in the case of ***Principal CIT Vs. M. Tech India Pvt. Ltd.***¹ wherein the Court relied upon the earlier decisions on the same issue including the judgment of this Court in ***Director of Income Tax v. Infrasoftware Ltd.***² and *inter alia* held that payment made by the reseller for the purchase of software for sale in Indian market could not be considered as royalty. The relevant portion of the said judgment reads as under:

*“12. In the cases where an Assessee acquires the right to use a software, the payment so made would amount to royalty. However in cases where the payments are made for purchase of software as a product, the consideration paid cannot be considered to be for use or the right to use the software. It is well settled that where software is sold as a product it would amount to sale of goods. In the case of **Tata Consultancy Services v. State of Andhra Pradesh**: (2004) 271 ITR 401 (SC), the Supreme Court examined the transactions relating to the purchase and sale of software recorded on a CD in the context of the Andhra Pradesh General Sales Tax Act. The court held the same to be goods within the meaning of Section 2(b) of the said Act and*

¹ (2016) 287 CTR (Del) 213

² (2014) 264 CTR (Del) 329



consequently exigible to sales tax under the said Act. Clearly, the ITA 890/2015 consideration paid for purchase of goods cannot be considered as ‘royalty’. Thus, it is necessary to make a distinction between the cases where consideration is paid to acquire the right to use a patent or a copyright and cases where payment is made to acquire patented or a copyrighted product/material. In cases where payments are made to acquire products which are patented or copyrighted, the consideration paid would have to be treated as a payment for purchase of the product rather than consideration for use of the patent or copyright.

*13. A Coordinate Bench of this Court has also expressed a similar view in the case of **Infrasoft (surpa)**. In that case, the Revenue sought to tax the receipts on sale of licensing of certain software as royalty. The Tribunal held that there was no transfer of rights in respect of the copyright held by the Assessee in the software and it was a case of mere transfer of copyrighted article. This Court concurred with the Tribunal and held that what was transferred was not copyright or the right to use a copyright but a limited right to use the copyrighted material and that did not give rise to any royalty income.*

*14. Insofar as the reliance placed by the Revenue on the decision of the **Karnataka High Court in Samsung Electronics Co. (supra)** is concerned, a ITA 890/2015 Coordinate Bench of this Court in **Infrasoft (supra)** has unequivocally expressed its view that it was not in agreement with that decision. Thus, the said decision is of no assistance to the Revenue in this case.*

*15. In another case, **Dynamic Vertical Software India P. Ltd. (supra)**, this Court had reiterated the view that payment made by a reseller for the purchase of software for sale in the Indian market could by no stretch be considered as royalty.*

16. In the aforesaid view, the question framed must be answered in the affirmative, that is, in favour of the Assessee and against the Revenue.

17. The Appeal is accordingly dismissed. In the circumstances the parties are left to bear their own costs.”

9. Further, the learned ITAT also dealt with the contention of the Appellant-Revenue regarding Explanation 4 to Section 9 (1)(vi) of the Act for interpreting the terms used in Article 13 of the DTAA and observed in para 6 of the impugned order that “*In view of Section 90(2) of the Income Tax*



*Act, the assessee opts for Double Taxation Avoidance Agreement bet India and UK to override the provisions of the Act as there is no corresponding amendment to the definition of the term 'royalty' in Article 13(3) of the aforesaid DTAA as carried out in the definition of royalty u/s 9(1)(6) of the Act.” The learned ITAT then rejected the contention of the Appellant-Revenue by relying upon the judgment of this Court in **Director of Income Tax v. New Skies Satellite BV & Ors.**³ which deals with the question of retrospective effect of the amendment. The relevant portion as quoted in para 8 of the impugned order is reproduced herein below-*

“8....

The Ld. DR's contention was that as per the judgment in the case of Shine Satellite, the amendment has to be given retrospective effect. But when we read the judgment of the Hon'ble High Court in case of New Sky Satellite, the Hon'ble Delhi High Court held in para 60 as follows:

"60. Consequently, since we have held that the Finance Act, 2012 will not affect Article 12 of the DTAA's, it would follow that the first determinative interpretation given to the word "royalty" in Asia Satellite, when the definitions were in fact pari material (in the absence of any contouring explanations), will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a Double Tax Avoidance Agreement, unless the said DTAA's are amended jointly by both parties to incorporate income from data transmission services as partaking of the nature of royalty, or amend the definition in a manner so that such income automatically becomes royalty. It is reiterated that the Court has not returned a finding on whether the amendment is in fact retrospective and applicable to cases preceding the Finance Act of 2012 where there exists no Double Tax Avoidance Agreement.

61. For the above reasons, it is held that the interpretation advanced by the Revenue cannot be

³ (2016) 285 CTR (Del) 1



accepted. The question of law framed is accordingly answered against the Revenue. The appeals fail and are dismissed, without any order as to costs. "

Therefore, in fact, the reliance of New Sky Satellite by the Ld. DR is favouring the assessee's case and the issue involved before us is squarely covered by the judgment of Infra Soft Pvt. Ltd. as well as New Sky Satellite (Shine Satellite)."

10. The questions of law urged by Appellant-Revenue in the present case are thus covered by the decisions of this Court in *M. Tech India Pvt. Ltd. (supra)* and *New Skies Satellite BV & Ors. (supra)*. Therefore, no substantial question of law arises for our consideration and accordingly, the present appeals are dismissed.

SANJEEV NARULA, J

MANMOHAN, J

NOVEMBER 24, 2020

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