Webinar on Supreme Court decision in Engineering Analysis Centre of Excellence (P) Ltd v. CIT [2021] 125 taxmann.com 42 (SC) & its impact on (i) Software download/SAAS (ii)Database subscription (iii) Taxability of software under Explanation 4 Section 9(1)(vi) of IT Act, 1961

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21 October, 2021

SML tax chamber

A. Engineering Analysis Centre of Excellence (P.) Ltd. [2021] 125 taxmann.com 42 (SC)

B. Impact of Supreme Court Judgement in Engineering Analysis Centre of Excellence (P) Ltd on Software download/SAAS

C. Impact of Supreme Court Judgement in Engineering Analysis Centre of Excellence (P) Ltd on Database Subscription

D. Impact of Supreme Court Judgement in Engineering Analysis Centre of Excellence (P) Ltd on taxability of software under Explanation 4 of IT Act, 1961

A] Engineering Analysis Centre of Excellence (P.) Ltd.- Synopsis

1. Relevant Provisions

ISSUE 1

- ***Taxability under the DTAAs / withholding tax obligation u/s 195- w.r.t consideration paid for purchase of shrink-wrap computer software, by I Co. to F Co.***

RELEVANT PROVISON

- Relevant extract of **Explanation 2** to section 9(1)(vi) of the Act

  "Explanation 2.- For the purpose of this clause, "royalty" means the ***consideration (including any lum sum consideration*** *but excluding any consideration which would be the income of the recipient chargeable but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains")* ***for—***

  (i)……

  …….

  (v) the **transfer** of **all or any rights** (**including the granting of a licence**) **in respect of** any **copyright, literary,** artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting [,but not including consideration for the sale, distribution or exhibition of cinematographic films] ; or ……."

A] Engineering Analysis Centre of Excellence (P.) Ltd.- Synopsis
1. Relevant Provisions

- **Explanation 4** to section 9(1)(vi) of the Act

  *"Explanation 4. — **For the removal of doubts**, it is hereby clarified that the **transfer** of all **or any rights** in respect of **any right, property** or **information includes** and has always included transfer of **all or any right for use or right to use a computer software** (including **granting of a license**) irrespective of the medium through which such right is transferred."*

- As an illustration **— Article 12(3)** of the India-Singapore DTAA

  "3. The term "royalties" as used used in this Article means payments of any kind received as a **consideration for the use of , or the right to use :**

  (a) any copyright of a literary, *artistic or scientific work, including cinematograph film or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information ;*

  (b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8."

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2. Facts

FACTS

- The assessee, an Indian Co., imported shrink-wrapped computer software from an F Co. During AY 2001-2002 and 2002-2003, the assessee made payment to the said F Co. for the purchase of shrink-wrapped computer software without deduction tax at source.

- The Assessing Officer (AO) held that the F Co. had transferred copyright in the said software and hence the payment was taxable as royalty under the Act as well as under the relevant DTAA, and hence the assesse was held as an 'assessee in default'. The Commissioner of Income-tax (Appeals) [CIT(A)] dismissed the appeal of the assessee, however the Tribunal decided in favor of the assessee. On further appeal, the Karnataka High Court held that since no withholding application was made u/s 195(2) of the IT Act, the assessee was liable to deduct tax at source u/s 195(1) of the IT Act.

- On further appeal, the Supreme Court (hereinafter referred as 'SC') while adjudicating / disposing a batch of **103 connected appeals**, categorized the appeals under the following four categories:
  - Sale of software directly by non-resident (NR) - to an **end user**
  - Sale of Software by an NR - **to Indian distributors for resale to end customers** in India
  - Sale of software by an NR - **to a foreign distributor for resale to end customers in India**
  - Sale of **software bundled with hardware** by an NR - to **Indian distributors** or **end users**

- On further appeal, the Supreme Court held:

A] Engineering Analysis Centre of Excellence (P.) Ltd.- Synopsis

3. Applying the provisions of DTAA at the time of witholding taxes u/s 195

- After taking into consideration the provisions of **section 4, section 5, section 9, section 90 and section 195** of the IT Act, the SC held that once provisions of **DTAA** are applicable to a non-resident, the provisions of the IT Act could only apply **to the extent that they are more beneficial** to the assessee and not otherwise. The SC reaffirming the position laid down in **GE Technology Centre Pvt Ltd** v. CIT [2010] 193 Taxman 234 (SC) and **Vodafone International Holdings BV** v. UOI [2012] 17 taxmann.com 202 (SC), held that **the machinery provisions u/s 195** of the Act were inextricably **linked with the charging provisions** (i.e. section 4, section 5 and section 9), as a result of which, tax withholding obligation arose only when the payment to the non-resident was chargeable to tax under the provisions of the IT Act, read with the DTAA.

- The SC also referred to the **CBDT Circular No 728 dated 30 October 1995**, wherein it was clarified that the **tax deductor should take into consideration the effect of the DTAA provisions** in respect of payment of royalties and technical fees while deducting taxes at source u/s 195 of the IT Act.

- Further, the SC also distinguished the decision of SC in case of **PILCOM v. CIT [2020] 271 Taxman 200 (SC)** by observing that the said judgement was in the context of **section 194E** of IT Act, dealing with "income" payable to a non-resident sportsman which does not have any reference to payments made to non-resident being ***"chargeable to tax"*** as in section 195 under the Act.

4. Copyright Act, 1957

- **Explanation 4 to section 90** of the IT Act provides that **if any term used in the DTAA** is defined therein, the said term shall have the **same meaning** as assigned to it under the said DTAA; and where any term is not defined in the DTAA, **but defined in the Act,** the **said term shall have the same meaning** as assigned to it in the Act and explanation, if any, given to it by the Central Government.

- **Article 3(2)** of the DTAA provides that **any term not defined in the DTAA shall**, **unless the context otherwise requires**, have, the meaning which it has under the **law of that State** concerning the taxes to which the DTAA applies.

- Further, the SC observed that the expression **"copyright"** has to be understood in the context of the **statute which deals with it**, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA.

- Section 16 of the Copyright Act provides as follows –

  *"16. No copyright except as provided in this Act.-- **No person shall be entitled to copyright** or any similar right in any work, whether published or unpublished, **otherwise than under and in accordance with the provisions of this Act** ……."*

4. Copyright Act, 1957

- Section 14 of the Copyright Act provides as follows–

*"14. **Meaning of copyright.**-- For the purposes of this Act, **copyright means the exclusive right** subject to the provisions of this Act, **to do or authorise the doing of any of the following acts** in respect of a work or any substantial part thereof, namely–*

*(a) **in the case of a literary, dramatic or musical work, not being a computer programme,--***

*(i) **to reproduce the work** in any material form including the storing of it in any medium by electronic means;"*

*(ii) to **issue copies** of the work to the public not being copies already in circulation;*

(iii) to perform the work in public, or communicate it to the public;

(iv) to make any cinematograph film or sound recording in respect of the work;

(v) to make any translation of the work;

(vi) to make any adaptation of the work;

(vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

*(b) in **the case of a computer programme**–*

(i) to do any of the acts specified in clause (a);

*(ii) to **sell or give on commercial rental** or offer for sale or for commercial rental any **copy of the computer programme**:*

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental."

4. Copyright Act, 1957

- Section 2(y) of the Copyright Act provides as follows–

  *"(y) **"work" means** any of the following works, namely:—*
  *(i) **a literary**, dramatic, musical or artistic work;*
  (ii) a cinematograph film;
  (iii) a [sound recording]"

- Section 2(O) of the Copyright Act provides as follows–

  *"(o) **"literary work" includes computer programmes**, tables and compilations **including computer databases;**"*

- Section 2(ffc) of the Copyright Act provides as follows–

  *"(ffc) **"computer programme"** means a **set of instructions expressed in words, codes, schemes** or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result;"*

- Section 30 of the Copyright Act provides as follows–

  *"30. **Licences by owners of copyright.—** The **owner of** the **copyright in any existing work** or the prospective owner of the copyright in any future work **may grant any interest in the right by licence** in [writing by him] or by his duly authorised agent:*

  Provided that in the case of a licence relating to copyright in any future work, the licence shall take effect only when the work comes into existence.

Explanation.— Where a person to whom a licence relating to copyright in any future work is granted under this section dies before the work comes into existence, his legal representatives shall, in the absence of any provision to the contrary in the licence, be entitled to the benefit of the licence."

- Section 52 of the Copyright Act provides as follows–

  "*52. **Certain acts not to be infringement of copyright.***

  (1) The following acts shall not constitute an infringement of copyright, namely,--

  ……..

  *(aa) **the making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copy**–*

  *(i) **in order to utilise the computer programme for the purpose for which it was supplied**; or*

  *(ii) **to make back-up copies purely as a temporary protection against loss, destruction** or damage in order only to utilise the computer programme for the purpose for which it was supplied;"*

- **The SC observed that the right to reproduce a computer programme and exploit the reproduction by way of sale, transfer, license etc. is at the heart of the said exclusive right.**

5. Doctrine of first sale/principle of Exhaustion- Section 14(b)(ii) of the Copyright Act

- **A copyright owner has an exclusive right to make copies and distribute the same.**

- On the **first occasion** when the **copyright owner parts with its distribution rights (i.e. the right to distribute copies of the work), his rights in the work gets exhausted. This is known as the Doctrine of First Sale / Principle of Exhaustion.**

- **Revenue argued that the Doctrine of First Sale / Principle of Exhaustion was not applicable to the sale of software** in light of the provision of section 14(b)(ii) of the Copyright Act, which is reproduced as under:

  "14. Meaning of copyright.-- For the purposes of this Act, copyright means the exclusive right subject to the provisions of this Act, to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely--

  …….

  (b) in the case of a computer programme–

  ……

  (ii) ***to sell or give on commercial rental*** *or offer for sale or for commercial rental* ***any copy*** *of the* ***computer programme*** *(regardless of whether such copy has been sold or given on hire on earlier occasions – deleted)"*

- The SC observed that - ***"After the 1999 Amendment, what is conspicuous by its absence is the phrase "regardless of whether such copy has been sold or given on hire on earlier occasions". This is a statutory recognition of the doctrine of first sale/principle of exhaustion."***

5. Doctrine of first sale/principle of Exhaustion- Section 14(b)(ii) of the Copyright Act

- A copyright owner has an exclusive right to make copies and distribute the same.

- The SC referred to the ***locus classicus*** **on the subject** i.e. **Copinger and Skone James on Copyright** (14th Edition) (1999), as follows:

  "The distribution right: general. ***One of the acts restricted*** *by the copyright in all work is* ***the issue of the original or copies of the work to the public****, often called the* ***"distribution right".***

  ……

  "Exhaustion of the distribution right: tangible objects. Exhaustion applies to the tangible object into which a protected work or its copy is incorporated if it has been placed on the market with the copyright holder's consent."

- The SC referred to the decision of **Delhi High Court** in case of **Warner Bros. Entertainment Inc.** v. Santosh V.G., CS (OS) No. 1682/2006 reported in 2009 SCC OnLine Del 835, wherein the Single Judge bench held as under:

  "58. Exhaustion of rights is linked to the distribution right. The right to distribute objects (making them available to the public) means that such objects (or the medium on which a work is fixed) are released by or with the consent of the owner as a result of the transfer of ownership. In this way, the owner is in control of the distribution of copies since he decides the time and the form in which copies are released to the public. ***Content-wise the distribution right are to be understood as an opportunity to provide the public with copies of a work and put them into circulation, as well as to control the way the copies are used. The exhaustion of rights principle thus limits the distribution right, by excluding control over the use of copies after they have been put into circulation for the first time."***

5. Doctrine of first sale/principle of Exhaustion- Section 14(b)(ii) of the Copyright Act

- The SC observed that likewise, **when it comes to section 14(a)(ii) of the Copyright Act, the distribution right subsists with the owner of copyright to issue copies of the work to the public, to the extent such copies are not copies already in circulation, thereby manifesting a legislative intent to apply the doctrine of first sale/principle of exhaustion, as has been found by the High Court of Delhi in Warner Bros. (supra).**

- The SC concluded as follows:

  "142. …….

  Thus, a distributor who purchases computer software in material form and resells it to an end-user cannot be said to be within the scope of the aforesaid provision. The sale or commercial rental spoken of in section 14(b)(ii) of the Copyright Act is of "any copy of a computer programme", making it clear that the section would only apply to the making of copies of the computer programme and then selling them, i.e., reproduction of the same for sale or commercial rental.

  143. The object of section 14(b)(ii) of the Copyright Act, in the context of a computer program, is to interdict reproduction of the said computer programme and consequent transfer of the reproduced computer programme to subsequent acquirers/end-users.

  ……

  Thus, once it is understood that the object of section 14(b)(ii) of the Copyright Act is not to interdict the sale of computer software that is "licensed" to be sold by a distributor, but that it is to prevent copies of computer software once sold being reproduced and then transferred by way of sale or otherwise, it becomes clear that any sale by the author of a computer software to a distributor for onward sale to an end-user, cannot possibly be hit by the said provision."

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6. Analysis of the License Agreements entered by the F Co. and I.Co

- W.r.t the **distribution agreements**, the SC observed as under:
  - It was evident that the distributor was granted only **a non-exclusive, non-transferable** license to **resell computer software** and it was expressly stated that **no copyright was transferred** either to the **distributor** or to the **ultimate end user.**
  - Further, **no right** was granted to sub-license or transfer, nor there was any right to **reverse engineer, modify, and reproduce** in any manner otherwise than permitted by the licence to the end user.
  - **What was paid for by way** of **consideration** by the distributor in India to the F Co., was therefore the **price of** a **copy of the computer programme as goods** (direct software sale or hardware embedded with software).

- W.r.t the category where the computer progamme was directly sold to the end user, the SC observed that the end user could only use the computer programme by installing it in the computer hardware and the end user could not reproduce the same for sale or transfer.

- The SC also observed that the License Agreements in all the appeals did **not** grant any such right or interest, least of all, **a right** or interest **to reproduce the computer software** u/s 14(a) and 14(b) of the Copyrights Act (supra) and **such reproduction was expressly interdicted**, and it was also expressly stated that no vestige of copyright was at all transferred, either to the distributor or to the end-user.

6. Analysis of the License Agreements entered by the F Co. and I.Co

- The SC relied on the decision of SC in case of **State Bank of India v. Collector of Customs (2000) 1 SCC 727** (though delivered under the **Customs Act** 1962) and observed that there was a difference between **'right to reproduce'** and **'right to use',** in as much as that under **right to reproduce, there would be a parting of the copyright by the owner thereof**, whereas in case of right to use, there would not be parting of any copyrights.

- Relying on the decision of the **SC** in case of **Tata Consultancy Services v. State of AP (2005) 1 SCC 308** (in the context of a sales tax statute), the SC observed that **what was "licensed"** by the F Co. to the I Co. and resold to the end-user, or directly supplied to the end-user, **was in fact the sale of a physical object which contained an embedded computer programme, and was therefore, a sale of goods.**

- With respect to the **Revenue's argument** that in some of the **EULA's**, it was clearly **stated** that **what was licensed to the distributor / end users by the non-resident would not amount to sale**, thereby making it clear that what was transferred was not goods – the SC, by placing reliance on **Sundaram Finance Ltd. v. State of Kerala, (1966) 2 SCR 828,** observed that the **real nature of the transaction** must be **looked** at upon, by **reading the agreement as a whole.**

7. Definition of royalty under the DTAA and the IT Act

- The SC observed that by virtue of explanation 4 to section 90 of the IT Act and under Article 3(2) of the DTAA, the definition of the term "royalties" shall have the meaning assigned to it by the DTAA, in Article 12. The said position was also clarified by CBDT Circular No. 333 dated 02.04.1982.

- Taking India-Singapore DTAA as the base, the SC observed that the **definition of royalty under the IT Act was much wider** than the definition under the DTAA, for the following three reasons:
  - 'consideration' under the IT Act also includes **lump sum consideration** other than income chargeable under the 'capital gains'
  - **Granting of a license** is expressly included within transfer of "all or any rights"
  - Transfer should be **"in respect of"** any **copyright of any literary work.**

- Further, the SC also observed that the **comma after the word "copyright" does not fit** as copyright would obviously exist only in a literary, artistic, or scientific work.

- The SC observed that the **transfer** (license or otherwise) of "all or any rights" (which includes the grant of a license) **in relation to copyright is a sine qua non** under explanation 2 to section 9(1)(vi) of the IT Act, in as much as that **there should be a parting with an interest in any of the rights mentioned in section 14(b) read with section 14(a)** of the Copyright Act.

7. Definition of royalty under the DTAA and the IT Act

- The SC had also observed that there would be **no difference in the position between the definition of "royalties" in the DTAAs and the definition of "royalty" in explanation 2(v) of section 9(1)(vi) of the IT Act**, to the extent of the expression "use of, or the right to use".

- The SC also held that **explanation 4 to section 9(1)(vi)** of the IT Act was **not clarificatory** in nature (as it expands the definition of royalty), by observing as under:
  - **Explanation 3 to section 9(1)(vi)** of the IT Act which refers to the term **"computer software",** was introduced for the first time with effect from **1st April, 1991** and therefore explanation 4 could not apply to any right for the use of or the right to use of computer software - even before the term "computer software" was inserted in the statute.
  - Under the **Copyright Act** the term **"computer software"** was introduced for the first time in the **definition of a literary work,** only in the year **1994** (vide Act 38 of 1994).
  - **Technology relating to transmission by a satellite, optic fibre or other similar technology, was regulated by the Parliament for the first time through the Cable Television Networks (Regulation) Act, 1995, much after the year 1976.**
  - Circular No. 152 dated 27th November, 1974 (cited by the Revenue) would not be applicable as it would then be explanatory of a provision (i.e. section 9(1)(vi) of the IT Act) that was introduced vide Finance Act, 1976

8. Obligation to withhold taxes pursuant the aforesaid retrospective amendments

- The SC, by relying upon two latin maxims - **lex non cogit ad impossibilia**, i.e., the **law does not demand the impossible** and **impotentia excusat legem** i.e., **when there is a disability that makes it impossible to obey the law**, **the alleged disobedience of the law is excused**, held that the "person" mentioned in **u/s 195** of the IT Act **could not** be **expected to do the impossible, namely, to apply the expanded definition of "royalty" inserted by explanation 4 to section 9(1)(vi) of the IT Act, at a time when such explanation was not actually and factually inserted in the statute.**

- The SC also relied on the decision in case of **Arjun Panditrao Khotkar v. Kailash Kushanrao Gorantyal,** (2020) 7 SCC 1, wherein on the basis of the aforementioned legal maxims, the respondent was relieved of the mandatory obligation to furnish certificate under the Evidence Act, 1872, after failing to obtain it despite several steps taken by the respondent. Further, the SC also referred to the decision of **Bombay HC ruling in NGC Networks (India)** (ITA No. 397/2015) in the context of explanation 6 to section 9(1)(vi) introduced in 2012 w.r.e.f. 1976 and **Western Coalfields Ltd.** (ITA No. 93/2008) in the context of retrospective amendment to section 17(2)(ii) to highlight the impossibility of discharging withholding obligation.

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9. AAR/High Court decisions upheld/set aside by the SC

- The **SC approved** the decision of **AAR** in case of **Dassault Systems, K.K.,** In Re., (2010) 322 ITR 125 (AAR) and **Geoquest Systems B.V.** Gevers Deynootweg, In Re., (2010) 327 ITR 1 (AAR) by observing that the **AAR had correctly applied the principle that the ownership of copyright in a work was different from the ownership of the physical material in which the copyrighted work may happen to be embedded.**

- Further the **adverse decision of AAR** in case of **Citrix Systems** Asia Pacific Ptyl. Ltd., In Re., (2012) 343 ITR 1 (AAR), was **set aside** as it did not state the law correctly, by observing as:
  - Under a non-exclusive license, an end-user only gets the right to use computer software in the form of a CD and does not get any of the rights that the owner continues to retain under section 14(b) of the Copyright Act read with sub-section (a)(i)-(vii) thereof.
  - The **AAR had incorrectly held that it was not constrained by the definition of 'copyright' under the Copyright Act** while construing the provisions of the DTAA, **without appreciating that u/s 16 of the Copyright Act no person shall be entitled to copyright otherwise than under the provisions of the Copyright Act** or any other law in force. The SC also observed that **the expression "copyright"** has to be **understood in the context of the statute which deals with it**, it being accepted that municipal laws which apply in the Contracting States must be applied unless there was any repugnancy to the terms of the DTAA.

9. AAR/High Court decisions upheld/set aside by the SC

- Similarly, the SC held the **Karnataka High Court in case of CIT v. Samsung Electronics Co. Ltd.,** (2012) 345 ITR 494 made the same error as done by the AAR in case of Citrix (supra) in as much as that **no distinction was made between a computer software that was sold/licensed on a CD/other physical medium and the parting of copyright** in respect of any of the rights or interest in any of the rights mentioned in sections 14(a) and 14(b) of the Copyright Act. In view of the same, the SC held that the payment for such computer software could not amount to royalty within the meaning of Article 12 of the DTAA or section 9(1)(vi) of the Income Tax Act.

- The SC also held that the decision of **CIT v. Synopsis International Old Ltd.,** ITA Nos. 11-15/2008, did not state the law correctly:
  - The observation of Karnataka High Court that the expression ***"in respect of"*** **(copyright)** should be given a **wider meaning i.e. "attributable"** to the copyright and therefore consideration paid for **transfer of a copyrighted article**, **would be taxable**, though the right in the copyright is not transferred, since a right in respect of a copyright contained in the article is transferred.
  - **Section 16** of the Copyright Act, which states that *"no person shall be entitled to copyright…otherwise than under and in accordance with the provisions of this Act or of any other law for the time being in force"* made it clear that the expression *"copyright"* had to be understood in terms of section 14 of the Copyright Act and not otherwise.
  - The HC was wholly incorrect in holding that the **storage of a computer programme** per se would constitute **infringement** of copyright, since it would directly be **contrary to** the provisions of **section 52(1)(aa)** of the Copyright Act.

- The finding that **when a copyrighted article** was sold, the **end-user gets the right to use** the intellectual property rights embodied in **the copyright** which would therefore amount to transfer of an exclusive right of the copyright owner in the work, was **wholly incorrect.**

- The **SC approved** the decision of **Delhi High Court** in case of DIT v. **Ericsson A.B.** [2012] 343 ITR 470 (Del), DIT v. **Nokia Networks OY** [2013] 358 ITR 259 (Del), DIT v. **Infrasoft Ltd.** [2014] 264 CTR 329 (Del), CIT v. **ZTE Corporation** [2017] 392 ITR 80 (Del), by observing:
  - **Copyright is an exclusive right**, which is **negative in nature**, **being a right to restrict others from doing certain acts.**
  - Copyright is an **intangible, incorporeal right, in the nature of a privilege,** which is quite **independent of** any **material substance**. Ownership of copyright in a work is different from the ownership of the physical material **in which the copyrighted work may happen to be embodied.**
  - **Parting with copyright entails parting with the right to do any of the acts mentioned in the Copyright Act.**
  - The transfer of the material substance does not, of itself, serve to transfer the copyright therein. The **transfer** of the ownership of the **physical substance**, **in which copyright subsists**, **gives the purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public**. No copyright is parted.

- The **right to reproduce** and **the right to use computer software are distinct and separate rights.**
- The **use of a copyrighted product cannot be construed as a license to enjoy** all or any of the enumerated **rights in the Copyright Act.**
- **It would make no difference as to whether the end-user was enabled to use computer software that is customised to its specifications or otherwise.**

- The SC also held that vide Circular No. 10/2002 dated 09.10.2002, the Revenue itself had appreciated the difference between the payment of royalty and the supply/use of computer software in the form of goods, which would be then treated as business income of the assessee taxable in India if it has a PE in India.

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10. Interpretation of the DTAAs in the light of the Model commentaries and India's position/ reservations on the said commentaries

- The SC, by placing reliance on the decision of **Azadi Bachao Andolan (2004) 10 SCC 1**, held that the **DTAAs** entered into between India and other Contracting States had to be **interpreted liberally with a view to implement the true intention of the parties.**

- The SC observed that the **DTAAs** under consideration had their staring point either from the **OECD Model Tax Convention** or the **UN Model Convention**, insofar as the taxation of royalty for parting with copyright was concerned. The definition of "royalties" under the concerned DTAAs were in a manner either identical with or similar to the definition contained in Article 12 of the OECD Model Commentary and therefore the same becomes relevant.

- The SC perused the **OECD Model Commentary** on Article 12, which supported the position that
  - There is a **distinction between** the **copyright in the program** and software which incorporates a copy of the **copyrighted program**.
  - **Making a copy or adaptation of a computer program to enable the use of the software for which it was supplied did not constitute royalty**
  - **Payment made by distributors and end users did not qualify as royalty.**

- Further, the SC also referred to the **India's positions / reservations** on the said **OECD Model Commentary** on **Article 12** and observed that the said positions / reservations **were not clear / vague** as contrasted with the categorical language used by India in its positions taken with respect to other aspects in Article 12.

10. Interpretation of the DTAAs in the light of the Model commentaries and India's position/ reservations on the said commentaries

- **India's position / reservation on the commentary dealing with computer software is as under:**

  "4.1 ***India reserves the right to: tax royalties*** *and fees for technical services at source;* ***define these,*** *particularly by* ***reference to its domestic law****; define the source of such payments, which may extend beyond the source defined in paragraph 5 of Article 11, and modify paragraphs 3 and 4 accordingly."*
  "17. India reserves its position on the interpretations provided *in paragraphs 8.2, 10.1, 10.2, 14, 14.1, 14.2, 14.4, 15, 16 and 17.3;* ***it is of the view that some of the payments*** *referred to* ***may constitute royalties"***

- **India's position / reservation on the commentary dealing with other aspect of Article 12 (eg. transponder charges) is as under:**

  "20. ***India does not agree with the interpretation in paragraph 9.1*** *of the Commentary on Article 12* ***according to which a payment for transponder leasing will not constitute royalty. This notion is contrary to the Indian position that income from transponder leasing constitutes an equipment royalty taxable both under India's domestic law and its treaties with many countries.*** *It is also contrary to India's position that a payment for the use of a transponder is a payment for the use of a process resulting in a royalty under Article 12. India also does not agree with the conclusion included in the paragraph concerning undersea cables and pipelines as it considers that undersea cables and pipelines are industrial, commercial or scientific equipment and that payments made for their use constitute equipment royalties."*

10. Interpretation of the DTAAs in the light of the Model commentaries and India's position/ reservations on the said commentaries

- Further, the **SC** also **referred** to the decision of **Delhi High Court** in case of **Director of Income Tax v. New Skies Satellite BV, (2016) 382 ITR 114** wherein it was held that **mere positions taken with respect to the OECD Commentary do not alter the DTAA's provisions, unless it were actually amended by way of bilateral re-negotiation.**

- Further, **it was also observed that after India took such positions qua the OECD Model Commentary, no bilateral amendments were made by India** and the other Contracting States to change the definition of royalties contained in any of the concerned DTAAs, in accordance with its position.

- The SC also observed that though **India-Singapore DTAA** and **India-Mauritius DTAA** were **amended** several times, however **no changes in the definition of 'royalty'** was made. Therefore, it was thus clear that the **OECD Commentary** on Article 12 of the OECD Model Tax Convention, incorporated in the concerned DTAAs had a **persuasive value** as to the interpretation of the term "royalties" contained therein.

- The SC also observed that the **OECD Commentary** would be **significant for persons deducting tax / for assessees** to conclude business transactions on the basis that they are to be taxed either on income by way of royalties for parting with copyright, or income derived from licence agreements which would be then taxed as business profits depending on the existence of a PE in the Contracting State.

- The SC also held that the **HPC Report 2003 and the E-Commerce Report 2016** were recommendatory reports expressing the views of the committee members, which the Government of India may accept or reject and however, for the purpose of DTAA, **a DTAA would have to be bilaterally amended before any such recommendation can become law in force** for the purposes of the IT Act.

Question of applicability of the judgement on following:

Applicability of the judgement of Hon'ble Supreme Court in Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT [2021] 125 taxmann.com 42 (SC) to non-customised computer software which is downloaded from a website Software as a Service ('SaaS')?

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

11. Physical object- not relevant in light of- Copyright Act

The Supreme Court relied on its co-ordinate bench ruling in **Tata Consultancy Services v. State of AP 2005 (1) SCC 308.** The relevant findings of the Supreme Court is reproduced hereunder for sake of convenience:

> *"52. There can be no doubt as to the real nature of the transactions in the appeals before us. What is "licensed" by the foreign, non-resident supplier to the distributor and resold to the resident end-user, or directly supplied to the resident end-user, is in fact the* ***sale of a physical object which contains an embedded computer programme****, and* ***is*** *therefore,* ***a sale of goods****, which, as has been correctly pointed out by the learned counsel for the assessees, is the law declared by this Court in the context of a sales taxstatute in Tata Consultancy Services v. State of A.P., 2005 (1) SCC 308 (see paragraph27)."*

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

12. Physical object- not relevant in light of- Copyright Act

Section 14 of the Copyright Act provides as follows–

*"14. **Meaning of copyright.--** For the purposes of this Act, **copyright means the exclusive right** subject to the provisions of this Act, **to do or authorise the doing of any of the following** acts in respect of a work or any substantial part thereof, namely–*

(a) in the case of a literary, dramatic or musical work, not being a computer programme,--

*(i) **to reproduce the work** in any material form including the storing of it in any medium by electronic means;"*

*(ii) **to issue copies of the work** to the public not being copies already in circulation;*

(iii) to perform the work in public, or communicate it to the public;

(iv) to make any cinematograph film or sound recording in respect of the work;

(v) to make any translation of the work;

(vi) to make any adaptation of the work;

(vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

*(b) **in the case of a computer programme**–*

*(i) **to do any of the acts specified in clause (a);***

(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental."

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS
12. Physical object- not relevant in light of- Copyright Act

Section 30 of the Copyright Act provides as follows–

"30. Licences by owners of copyright.— The owner of the copyright in any existing work or the prospective owner of the copyright in any future work may grant any interest in the right by licence in [writing by him] or by his duly authorised agent:

Provided that in the case of a licence relating to copyright in any future work, the licence shall take effect only when the work comes into existence.

Explanation.— Where a person to whom a licence relating to copyright in any future work is granted under this section dies before the work comes into existence, his legal representatives shall, in the absence of any provision to the contrary in the licence, be entitled to the benefit of the licence."

[Para 33 of the aforesaid decision]

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

13. Physical object- not relevant in light of- Ratio of Supreme Court in Engineering Analysis

"36. In essence, such right is referred to ***as copyright****, and* ***includes the right to reproduce the work*** *in any material form,* ***issue copies of the work to the public,*** *perform the work in public, or make translations or adaptations of the work. This is made even clearer by the definition of an "infringing copy" contained in section 2(m) of the Copyright Act, which in relation to a computer programme, i.e., a literary work, means reproduction of the said work.* ***Thus, the right to reproduce a computer programme and exploit the reproduction by way of sale, transfer, license etc. is at the heart of the said exclusive right…***

117. The conclusion that can be derived on reading of the aforesaid judgements are as follows….

iii) Parting with copyright entails parting with the right to do any of the acts mentioned in section 14 of the Copyright Act. The transfer of the material substance does not, of itself, serve to transfer the copyright therein. ***The transfer of the ownership of the physical substance, in which copyright subsists, gives the purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public,*** *unless such copies are already in circulation,and the other acts mentioned in section 14 of the Copyright Act…*

vi) ***The right to reproduce and the right to use computer software are distinct and separate rights,*** *as has been recognized in SBI v. Collector of Customs, 2000 (1) SCC 727 (see paragraph 21), the former amounting to parting with copyright and the latter, in the context of non-exclusive EULAs, not being so."*

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS
14. Physical object- not relevant in light of- OECD Commentary

*"152. The **OECD Commentary on royalty payments under Article 12 is instructive, and states as follows :'……14.1 The method of transferring the computer program to the transferee is not relevant**. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the program or directly receives a copy on the hard disk of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software……"*

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS
14. Physical object- not relevant in light of- OECD Commentary

*"**17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, e.g. because a right to make one or more copies of the digital content is granted under the contract. Where** the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and **the use of copyright is limited** to such rights as are required **to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device,** such use of copyright should **not** affect the analysis of the character of the payment for purposes of applying the definition of **"royalties**"."*

17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties but falls within Article 7 or Article 13, as the case may be. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored…

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS
15. Physical object- not relevant in light of- Provisions of Income Tax Act, 1961

Explanation 3 to section 9(1)(vi) of the Act defines computer software to mean
"any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data."..

"Explanation 4 to Section 9(1)(vi)— For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or ***any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred."***

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS
16. Physical object- not relevant in light of- Black's Law Dictionary

*"**Computer software is a set of instructions that runs on a computer.** It does not consists solely of programming language. Rather, from a technical perspective, **software is defined as a program** and all of the associated information and materials needed to support its installation, operation, repair and enhancement. **It also includes written programme**, procedures, rules and associated documentation pertaining to the operation of computer system, **which are stored on digital medium**. Indeed, because computer software instructs a computer how to perform actions, in the broadest sense, it includes everything that is not hardware. Put another way, computers are, in effect, incomplete machines when manufactured and acquire functionality only after being coupled with software."*
Daniel B. Garrie & Francis M. Allegra, Plugged in: Guidebook to Software and the Law – 2.1 at 45-46 (2013)"

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

17. Physical object- not relevant in light of- Supreme Court ruling in Collector of Customs and Central Excise and Ors v. Lekhraj Jessumal and Sons and Ors (1996) 7SC C 489

wherein the Supreme Court observed "The Division Bench observed, in our view, very rightly, that such an interpretation over-looked that **industry was not static and that there was continuous technical progress therein. New processes and new methods developed from time to time and new material and components or types of components superseded others. It was unreasonable to give a static interpretation** to words used in a tariff schedule **ignoring the rapid march of technology.".**

miniature switches
reed switches
] for hearing aid

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

18. Physical object- not relevant in light of- Dassault Systems K.K., re [2010] 188 Taxmann 223 (AAR)- approved by SC

- Company incorporated under the laws of Japan and **engaged in the business of providing 'Product Lifecycle Management' Software Solutions,** applications and services.

- On acceptance of the order by the assessee, **it would provide a license key via e-mail so that the customer could directly download the product through the web link.**

The Authority for advance rulings held as under:

- Licensed programme is made available to the licensee directly through electronic delivery the details of which have already been set out.

- **In the instant case, the end-user is not given the authority to do any of the acts contemplated in sub-clauses (i) to (vii) of clause (a) of section 14, not to speak of the exclusive right to do the said acts.**

- Where the purpose of the licence or the transaction is only to establish access to the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself has been transferred to any extent.

B] Impact of SC in Engineering Analysis on payment for- SOFTWARE DOWNLOAD/SAAS

19. Conclusion

It would be pertinent to note that in, the aforesaid case, a license key was provided via e-mail so that the customer could directly download the software through the web link. **The said decision which was also before the Hon'ble Supreme Court along with the case of Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT (supra) and the aforesaid ruling has been granted express approval from the Supreme Court.** Thus, as self-evident from above, I may reiterate, that the decision of Hon'ble Supreme Court in **Engineering Analysis** Centre of Excellence (P.) Ltd. v. CIT (supra) would be squarely **applicable to softwares which are downloaded from the internet or SaaS notwithstanding that the same are not embedded into a physical material / substance such as a CD / pen drive etc.**

C] Impact of SC in Engineering Analysis on payment for- DATABASE SUBSCRIPTION

20. Issue

Applicability of the judgement of Hon'ble Supreme Court in Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT [2021] 125 taxmann.com 42 (SC) whether payment/subscription for non-customised access to online database- is taxable as royalty?

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

21. Whether Copyright?

i. Section 14 of theCopyright Act, 1957 which defines **'copyright'** to mean the **exclusive right to do** or authorise the doing of **certain specified** acts interalia **in respect of a 'literary work**'

ii. The Term '**literary work**' has been defined under section 2(o) of the copyright Act, 1957 **to include within its purview computer programmes**, tables and compilations including **computer databases.**

iii. Thus, in light of the above, in my view, the judgement of the Hon'ble **Supreme Court** in Engineering Analysis Centre of Excellence (P) Ltd. (Supra) rendered in connection with taxability of computer software, would be equally **applicable** to non-customized **computer database also.**

iv. **Consequently**, the payments made for **accessing the said computer database** would not fall within the purview of '**royalty'** if the same does not **result in transferring of all or any rights referred to in section 14 of the Copyright** Act, 1957.

v. Therefore, unless **exclusive rights of reproduction of computer database is transferred** so as to enable its exploitation by making / selling copies of the same, the payment made for accessing such computer database would be categorized as payments made for accessing a copyrighted article / copyrighted material and not for copyright per se. Consequently, the said payment would not amount to royalty.

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION
22. Whether for- information concerning industrial, commercial or scientific experience

Since 'data' is synonymous with the term 'information', would payments for accessing a non-customized computer data fall within the purview of the expression

RELEVANT PROVISON

- Relevant extract of **Explanation 2** to section 9(1)(vi) of the Act

"Explanation 2.- For the purpose of this clause, "royalty" means the ***consideration (including any lum sum consideration*** *but excluding any consideration which would be the income of the recipient chargeable but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains")* ***for—***

(i)……

…….

(iv) the imparting of any **information concerning technical, industrial, commercial or scientific knowledge, experience or skill;**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

22. Whether for- information concerning industrial, commercial or scientific experience

i. **The aforesaid phrase alludes to the concept of knowhow which is all the undivulged technical information that is necessary for the industrial reproduction of a product ;** whereas the payment for accessing the aforesaid **database** would **not result in acquisition of any knowhow or intellectual property rights** in the hands of the subscriber to the database.

ii. the **information** which the licensee would get through the abovementioned database would **not relate to the underlying experience or skills which contributed** to the end product as the database owner or licensor would not normally share with the subscribers his experiences, techniques or methodology employed in evolving the database.

iii. **the payment** made would also **not** be for the **use or the right to use one's (i.e.the database owner's) experience but would really be for the application / outcome of his experience to a certain factual situation.**

iv. **Normally,** when a non-customized / non-exclusive access to a database is granted, the **database owner** or licensor **would not grant the exclusive rights of reproduction to the subscriber permitting him to make copies of the said database** for further sale, transfer, license etc. and thus, the payments made for accessing a non-customized / non-exclusive computer database would merely amount to **payments for accessing a copyrighted information and not for "*information concerning industrial, commercial or scientific experience*"royalty so as to constitute royalty.**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION
22. Whether for- information concerning industrial, commercial or scientific experience

v. In addition to the above, in **appropriate cases**, it may also be **possible to contend** that since normally, **payments to access database is independent of the actual usage of the said database** (by the subscriber / licensee) and the same **is akin to a gate pass or an entry fee**, whereby the **subscriber may or may not access the said database,** such **payments** would **therefore not be for imparting of any information** concerning industrial, commercial or scientific knowledge, experience, skill so as constitute royalty.

Reference may be made to the following decisions, which support the aforesaid view:

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

ITO v. Cadila Healthcare Ltd. [2017] 77 taxmann.com 309 (Ahmedabad-trib.)

In the said case, the assessee made payment to a US based entity for access to its online publication database. **The Tribunal held** as under:

"17. …. In the present case, **the payment is for the use of copyrighted material rather than for the use of copyright.** The distinction between the copyright and copyrighted article has been very well pointed out by the decisions of Hon'ble Delhi High Court in the case of **DIT v. Nokia Networks OY [2013] 358 ITR 259/212 Taxman 68/25 taxmann.com 225.** In this case all that the assessee gets right is to access the copyrighted material and there is no dispute about…..

In our considered view, it was simply a case of copyrighted material and therefore the impugned payments cannot be treated as royalty payments." …

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

DCIT v. Welspun Corporation Ltd. [2017] 77 taxmann.com (Ahemdabad- Trib)

In the said case, the assessee made payments of subscription fees for a specialized database containing copyright material.

The Tribunal held as under:

"49. … it is only when the use is of the copyright that the taxability can be triggered in the source country. In the present case, **the payment is for the use of copyrighted material rather than for the use of copyright.** The distinction between the copyright and copyrighted article has been very well pointed out by the decisions of Hon'ble Delhi High Court in the case of **DIT v. Nokia Networks OY [2013] 358 ITR 259/212 Taxman 68/[2012] 25 Taxmann.com 225.** In this case all that the assessee gets right is to access the copyrighted material and there is no dispute about. ….

It was simply a case of copyrighted material and therefore the impugned payments cannot be treated as royalty payments."…..

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Reliance Corporate IT Park. v. DCIT [TS-845-ITAT-2019(Mum)]

Wherein the Tribunal held as under:

The Tribunal held as under:

"6. **We find that the basic reasoning adopted by the learned CIT(A), for holding that the payment for software licence is royalty, is the access to "significant proprietary database" being allowed** to the assessed by the software in question. **However, we find that assessee to database, in the context of materially similar DTAA provision, has been held to be outside the ambit of 'royalty'.** While holding so, the coordinate bench, in the case of ITO vs Cadila Healthcare Ltd. [(2017) 162 ITR 575 (Ahd)] has observed as follows:-…….

9. Respectfully following the above views, we hold that the payment for licence fee of software is not taxable in nature."

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

GVK Oil & Gas Ltd. v. ADIT [2016] 68 taxmann.com 134 (Hyderabad- Trib.)

a. In the said case, the assessee company was engaged in the business of Oil and Gas exploration. It had bid for the oil and gas exploration block offered under the Ministry of Petroleum and Natural Gas.

b. To understand the geological and seismic quality of the block in order to optimise the risk of exploration and in order to evaluate various blocks, the **assessee** required available geological and seismic data and for the said purpose it **had entered into agreements** with GXT, a **USA** based Corporation and a leading provider of a comprehensive range of advanced seismic Data and Derivatives and GGS, a **UK** based company.

c. By virtue of these agreements, both the companies **agreed to grant non-exclusive license/right to use certain Data** and Derivatives in consideration **for an agreed license fee.**

d. The Assessing Officer held that the payment made by the assessee to GXT by way of **'license fee' amounted to consideration for information concerning industrial, commercial or scientific experience and as such constituted 'royalty' both under US as well as UK DTAA**

e. Since the assessee had failed to deduct tax at source under section 195 before making the payment, the Assessing Officer held the assessee to be 'an assessee-in-default' under section 201(1) and made the disallowance under section 201(1).

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

GVK Oil & Gas Ltd. v. ADIT [2016] 68 taxmann.com 134 (Hyderabad- Trib.)

The Hon'ble Tribunal held as under:

"……

8. Having regard to the rival contentions and the material on record, we find that the only dispute is the nature of the payment made by the assessee to M/s. GX Technology Corporation, USA and M/s. GGS Spectrum Limited, UK. In both these transactions, the assessee has acquired a non-exclusive license to use the data in consideration for an agreed license-fee. ….. **Thus, it is seen that the said product is highly technical and complicated and the data therein can be accessed only on the grant of a license by the owner.**

……

8.4.2 **In the case of Preroy A.G .** (supra) the Tribunal…. And **held** that:

"25. It is clear from the above commentaries that consideration for information concerning industrial, commercial and scientific experience is to be regarded as royalty, only if it is received from imparting know-how. However, providing strategic consulting services, which may entail the use of technical skills and commercial experience by a strategic consultant, does not amount to knowhow being imparted to the buyer of the strategic consulting services."

8.4.3 In the case of Real Resourcing Ltd. (supra) was dealing with the definition of 'FTS' under the India-UK DTAA and has held as under :

…….

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

GVK Oil & Gas Ltd. v. ADIT [2016] 68 taxmann.com 134 (Hyderabad- Trib.)

Moreover, by giving access to the database, it cannot be said that the information concerning industrial, commercial or scientific experience will be transmitted by the applicant ……..

Consideration for providing information concerning industrial, commercial or scientific experience basically involves the sharing of technical know-how and experience which is not the case here. ……

8.4.4 In the case of **Diamond Services International (P) Ltd.** (supra), the Hon'ble Bombay High Court while dealing with the definition of 'Royalty' under the DTAA between India and Singapore which is similarly worded as in the DTAA between India and UK has held as under:

'The grading report… gives the attributes of the diamond and includes an analysis of the diamond's dimensions, clarity, colour, polish, symmetry and other characteristics. There is nothing on record to show that GIA through its grade report assigns or transfers any industrial or commercial experience to its customers. **As per the dictionary meaning of the term "experience" it is clear that "experience" is a cumulation of knowledge and observation gathered over a period of time.** The grading certificate which is issued does not involve any transfer of commercial interest to the party paying or getting the right to use the experience of GIA.

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

GVK Oil & Gas Ltd. v. ADIT [2016] 68 taxmann.com 134 (Hyderabad- Trib.)

8.4.4 There is also no transfer of any skill knowledge of GIA to the customers in the issuance of grading reports. **The payment received is not the one for the use or the right to use experience, but is instead one for the application of experience to a certain factual situation…..**

The nature of the transaction between GIA and its client does not invest the party making payment with any right as regards the use of the cumulated experience of GIA. **The payment in question does not involve a payment for the use or the right to use the industrial, commercial or scientific experience of GIA. The activity of grading or certification is merely the application of this knowledge/ experience in a professional stream as applicable to a particular diamond or set of diamonds which are offered for certification or grading.**

The definition of royalty under the DTAA under art. 12(3) as defined therein, uses the expression "or for information concerning industrial, commercial or scientific experience". There is no parting of information concerning industrial, commercial or scientific experience by GIA when it issues the grading certificate…..

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

GVK Oil & Gas Ltd. v. ADIT [2016] 68 taxmann.com 134 (Hyderabad- Trib.)

9. … unless and until the license is given to use the copyrighted property itself, the consideration paid cannot be treated as 'Royalty'. In the case before us, **the license is granted to use certain data from time to time upon the terms and conditions set in the license agreement. It is seen that both the licenses are non-exclusive licenses and therefore, the information/DATA is not customized to meet the assessee's requirements exclusively….**

11. As seen from the above clauses, we find that all that is provided by the licensor is the Data relating to the geophysical and geological information about the east and west coast of India and is not responsible for the accuracy or usefulness of such Data. **Thus, it is clear that licensors have only made available the data acquired by them and available with them but are not making available any technology available for use of such data by the assessee herein.** The decisions relied upon by the Ld. Counsel for the assessee, for the cases discussed above are clearly applicable to the facts of the case before us and the payments made by the assessee to GTX and GGS is not in the nature of Royalty' as per the respective DTAA's and therefore, the provisions of Section 195 are not applicable."

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Real Resourcing Ltd. [2010] 190 Taxman 151 (AAR), wherein it was held as under:

wherein it was held as under:

"Moreover, by giving access to the data base, it cannot be said that the information concerning industrial, commercial or scientific experience will be transmitted….

Consideration for providing information concerning industrial, commercial or scientific experience basically involves the **sharing of technical know-how and experience which is not the case here."**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Wirpo Ltd. v. ITO [2005] 94 *ITD 9 (Bangalore)*

wherein it was held as under:

"2.1 The appellant made certain payments to Gartner Group (GG), USA/Ireland on which no TDS was deducted……..The appeals pertain to payments grouped in Table-I which are essentially annual subscription/fee paid for providing access to information available in the database maintained by GG Service…..

The data and analysis available with GG is published periodically through the web and on subscription…. From the contract of subscription entered into by the appellant, it is seen that GG maintains the data on a clustered basis and the data so maintained are all copyrighted in Stamford, CT-06904, USA….

5.1…….In this case facts are not in dispute that the GG was web based publishing house giving access to the data base to all those who are willing to pay. These payments are towards obtaining of market data and client's strategy details etc. **These are publications and is not an information or advice given individually. The information is available on subscription to anyone willing to pay. Further, it is a copyrighted information and cannot be passed on to anyone else**. ….

Fee is payable even if no service is utilized. It is like a gate pass or entry fee. And cannot be treated as imparting of information. The payment is for obtaining data and use it the way assessee wants it to be used. **It is for use of a copyrighted article and not for transfer of right in the copyright in the article….**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Wirpo Ltd. v. ITO [2005] 94 *ITD 9 (Bangalore)*

5.1 Further such an **access to data** base cannot fall within the scope of as found in **DTAA with USA - Article 12(3)(a),** the relevant portion is extracted hereunder:

"for information concerning industrial, commercial or scientific experience".

5.2 The experience mentioned in the DTAA should be one's own experience in the realm of industrial, commercial and scientific and not compilation of somebody else's experience. To illustrate, experiences of Einstein, Thomas Edison, etc., are instances of experience within the DTAA, whereas a book on scientific experience cannot come within the scope of the law set out in the DTAA. **It is also to be seen that such experience should give rise to some known form of Intellectual Property Rights.** In this case as rightly pointed out no such thing exists. ……we hold that receipt of web based material offered by GG, outside India is not amenable for taxation in India……."

Reversed by HC – HC followed Samsung – Samsung set aside by SC

∴ ITAT = good law

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

India Capital Markets P. Ltd. v. DCIT (ITA No. 2948/Mum/2010)

Wherein it was held as under:

"24…. Ground No.1 relates to the deletion of the addition made by the Assessing Officer on account of non-deduction of TDS on **Bloomberg Data Services charges at Rs.4,74,109/-.**

25. Before the CIT(A), the **assessee explained that the payment was made for terminal charges for on line information and data base access…..**

26…… In that view of the matter and considering the fact that the **payment is nothing but a subscription** for e-magazine/ journal we do not find any infirmity in the finding of the CIT(A) and we confirm the same. Ground No.1 is accordingly dismissed."

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Kitara Capital Private Limited v. ITO (I.T.A. No. 130/Mum/2014)

Wherein it was held as under:

7….. the AO noticed that assessee had debited an amount of Rs.8,23,275/- towards subscription fees to M/s Bloomberg Data Services India Pvt.Ltd which according to the AO is in the nature of payments towards professional services hence, liable for TDS u/s 194J, ….

9. **The ld.DR….. he relied upon the decision of Karnataka High Court in the case of CIT V/s Samsung Electronics Co.Ltd (2011) 16 taxmann.com 141 (Kar). …**

10**. After analyzing the relevant facts we have noted that the subscription fee paid by the assessee to M/s Bloomberg Data Services India Pvt.Ltd data service was for accessing the database and is in the nature of subscription of emagazine/ journal. Therefore, the payment made cannot be treated as royalty or Fees Paid for Technical Services coming within the purview of section 194J….**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Elsevier Information Systems Gmbh v. DCIT [2019] 106 taxmann.com 401 (Mumbai Trib.)

Wherein it was held as under:

10. ….. Undisputedly, the assessee has created **an online database named "reaxys.com" pertaining to chemical information** which the users having interest in chemistry topic, substance data and preparation and reaction method can access for their own benefit and use.

……..

12….. **Further, the assessee retains its exclusive right and ownership over the intellectual property relating to the product and the users/subscribers are specifically debarred from using the data in any manner other than for their own exclusive purpose….**

13**…. It is also clear from the terms of subscription agreement, the assessee has not transferred use or right to use of any copyright of literary, artistic or scientific work to its subscribers. What the assessee has done is, it has allowed customers to access its database and utilize the information available therein for their use…**

There is no material on record which could even remotely demonstrate that while allowing the customer/users to the access the database, the assessee had transferred its right to use the copyright of any literary, artistic or scientific work to the subscribers….

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION
23. Favourable case laws

Elsevier Information Systems Gmbh v. DCIT [2019] 106 taxmann.com 401 (Mumbai Trib.)

15. A customer/subscriber can access the data stored in the database by paying subscription….

The observation of of the Tribunal while deciding the issue in favour of the assessee are as under:—

"17…. The distinction between the **copyright and copyrighted article** has been very well pointed out by the decisions of Hon'ble Delhi High Court in the case of **DIT v. Nokia Networks OY [2013] 358 ITR 259/212 Taxman 68/25 taxmann.com 225.** In this case all that the assessee gets right is to access the copyrighted material and there is no dispute about…..

the payment was not for use of copyright of literary database but only for access to the literary database…

In our considered view, it was simply a case of copyrighted material and therefore the impugned payments cannot be treated as royalty payments….

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Elsevier Information Systems Gmbh v. DCIT [2019] 106 taxmann.com 401 (Mumbai Trib.)

16…. the payment received by the assessee has to be held to have been received for use of copyrighted article rather than for use of or right to use of copyright.

17. Having held so, the next issue which arises for consideration is, whether the **subscription fee can be treated as fees for technical services…..**

The assessee has neither employed any technical/skilled person to provide any managerial or technical service nor there is any direct interaction between the customer/user of the database and the employees of the assessee. The customer/user is allowed access to the online database through various search engines provided through internet connection. **There is no material on record to demonstrate that while providing access to the database there is any human intervention. As held by the Hon'ble Supreme Court in CIT v. Bharati Cellular Ltd. (supra) and DIT v. A.P. Moller Maersk A.S. (supra), for providing technical/managerial service human intervention is a sin qua non. ….**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Elsevier Information Systems Gmbh v. DCIT [2019] 106 taxmann.com 401 (Mumbai Trib.)

17. The assessee even does not alter or modify in any manner the articles collated and stored in the database. In the aforesaid view of the matter, the subscription fee received cannot be considered as a fee for technical services as well. By way of illustration we may further observe, **online databases are provided by Taxman, CTR online,** etc. which are accessible on subscription not only to professionals but also any person who may be having interest in the subject of law. When a subscriber accesses the online database maintained by Taxman/CTR online etc. he only gets access to a **copyrighted article** or judgment and not the **copyright.** Similar is the case with the assessee. Therefore, in the facts of the present case, the subscription fee received by the assessee cannot be treated as royalty under Article-12(3) of India-Germany Tax Treaty."

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Mc Kansey Knowledge Centre India Pvt. Ltd v. ITO (2017) 50 CCH 0464 DelTrib,

wherein it was held as under:

14. **…. The payments made by assessee to Thomson are for merely accessing the database. With this access assessee has not received any knowledge as to how the databases are maintained nor does it have any licence for commercial exploitation of the Copyright with regard to the database maintained by Thomson. Assessee had claimed a limited right to use the information which is no doubt the "copyrighted information" solely belonging to Thomson under master agreement…..**

15. The clauses in agreement are non-exclusive, non transferable and information available on database has to be used in accordance with the agreement only. We agree with the arguement advanced by Ld. Counsel that in order to qualify payment made to Thomson as royalty payment it is necessary to establish that there is a transfer of all or any rights in respect of copyright of literary work. **It is observed that assessee is not allowed to exploit the database commercially under the agreement.**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Mc Kansey Knowledge Centre India Pvt. Ltd v. ITO (2017) 50 CCH 0464 DelTrib,

16. …. In the present case, the payment has been made by assessee for use of **"copyrighted material"** rather than for the use of copyright. The distinction between **"copyright" and "copyright article"** has been well dealt with by **Hon'ble Delhi High Court in the case of DIT vs. Infrasoft (supra),** wherein it has been held that in a case where assessee gets right to access "copyrighted material", there is no dispute regarding the same to fall out of definition of term "Royalty", under India Singapore DTAA. In this case, as assessee has only received access of copyrighted material, there is no dispute about payment falling out of definition of royalty. During course of hearing before us Ld. DR could not demonstrate as to how there was use of copyright and therefore, attempt to bring payments made under explanation 2 clause (iv) to section 9 (1) (vi) of the Act cannot be accepted.

Accordingly respectfully following decision of Hon'ble jurisdictional High Court in the case of DIT vs. Infrasoft Ltd. (supra) and on the basis of discussions above we allow grounds raised by assessee."

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Factset Research Systems Inc.., In re [2009] 182 Taxmann 268 (AAR),

Wherein it was held as under:

"9.3 We are, therefore, of the view that the subscription fee received by the applicant from the licensee (user of data base) does not fall within the scope of clause (v) of Explanation (2) to section 9(1) of the Act.

10**…. we do not think that "the use of or right to use any copyright of a literary or scientific work" is involved in the subscriber getting access to the database for his own internal purpose….**

The expression 'use' (of copyright) is not used in a generic and general sense of having access to a copyrighted work. The emphasis is on the "use of copyright or the right to use it". In other words**, if any of the exclusive rights which the owner of copyright (the applicant) has in the database are made over to the customer/subscriber so that he could enjoy such rights either permanently or for a fixed duration of time and make a business out of it, then, it would fall within the ambit of phrase 'use or right to use the copyright'….**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Factset Research Systems Inc.., In re [2009] 182 Taxmann 268 (AAR),

10…. **Is the licensee conferred with the right of reproduction and distribution of the reproduced work to its own clientele? Can it be publicly exhibited or its contents be communicated to the public?** Is the applicant given **the right to adapt or alter the 'work' for the purpose of marketing it?** The answer is obviously - no. The underlying copyright behind the data base cannot be said to have been conveyed to the licensee who makes use of the copyrighted product.

11….. The information which the licensee gets through the database does not relate to the underlying experience or skills which contributed to the end-product. **The applicant does not share its experiences, techniques or methodology employed in evolving the database with the subscribers. The applicant does not impart any information relating to them. ….**

11.3 We may also refer to the case of **Anapharm Inc.,** In re [2008] 305 ITR 394 in which this Authority has given ruling. The observations may be noted:

". . .While discussing paragraph (2) of article 12 of the OECD Model Convention, OECD Commentary at paragraph 11 state that **information concerning industrial, commercial or scientific experience alludes to the concept of know-how which is all the undivulged technical information that is necessary for the industrial reproduction of a product or process directly…..**

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

23. Favourable case laws

Factset Research Systems Inc.., In re [2009] 182 Taxmann 268 (AAR),

11.3 As the applicant uses its experience and skill itself in conducting the bio-equivalence tests, and provides only the final report containing conclusions, to the applicant. **The information concerning scientific or commercial experience of the applicant or relating to the method, procedure or protocol used in conducting bio-equivalence tests is not being imparted to the pharmaceutical companies and the consideration is not paid for that purpose. . .". (p 407)**

11.4 The counsel for the applicant has drawn our attention to the ITAT decision in Wipro Ltd.'s case (supra) in a similar matter concerning subscription to database of a web-based publishing house abroad in terms of user licence granted to the subscriber. The revenue's contention that the fee paid by licensee was in the nature of royalty was rejected. The distinction between transfer of rights in the copyright and authorizing use of copyrighted article was stressed. Moreover, it was held that the clause in Article 12(3)(a) of DTAA "information concerning industrial, commercial or scientific experience" was not applicable.

[I may point out for completeness that the judgements (ITA. No. 2948/Mum/2010), (I.T.A. No 130/Mum/2014), (ITO (2017) 50 CCH 0464 Del Trib) and ([2009] 182 Taxmann 268 (AAR) extracted above deal with the issue of royalty qua database under the Act]

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

24. Adverse case laws

- Mumbai Tribunal in case of **Gartner Ireland Ltd. v. ADIT [2013] 37 taxmann.com 16 (Mumbai),** has taken an **adverse view** by holding that subscription fee / access fee paid to subscribe to a research product / database sold would fall within the purview of royalty.

- The Tribunal while coming to the aforesaid conclusion had **relied on the Karnataka High Court** decision in case of **CIT (IT) v. Wipro Ltd. [2011] 203** Taxman 621/16 taxmann.com 275, which in turn has relied on the decision of **Karnataka High Court decision in case of CIT v. Samsung Electronics Co. Ltd. [2012] 345 ITR 494 (Karn.).**

- The decision of **Karnataka High Court** in Wipro Ltd. (supra) and Mumbai Tribunal in Gartner Ireland Ltd. (supra) are **no more good law since** the Karnataka High Court decision in Samsung Electronics Co. Ltd. (supra) itself has been overruled by the Supreme Court in Engineering Analysis Centre of Excellence (P.) Ltd. (supra)

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

24. Adverse case laws

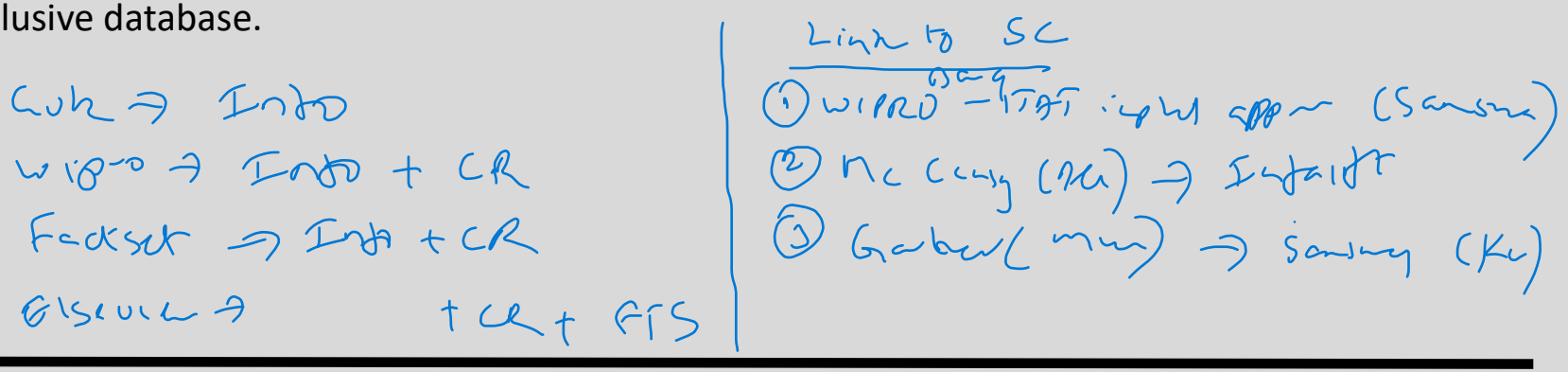
- **The Delhi Tribunal in Mc Kansey Knowledge Centre India Pvt. Ltd.** (supra) while coming to the conclusion that **consideration for accessing a computer database** would **not** fall within the purview of 'royalty' as the same was for the use of **"copyrighted material"** rather than for the use of "copyright", has relied on the decision of **Delhi High Court in DIT v. Infrasoft Ltd. (supra),** which in turn has been **approved by the Hon'ble Supreme Court** in Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT (supra).

- As regards the other adverse decision i.e. that of the Delhi Tribunal in the case of **ONGC Videsh Limited v. ITO (2012) 20 ITR 767 (Delhi-Trib.),** I may point out that the Delhi Tribunal did not have the benefit of the wisdom of the **Bombay High Court ruling in Diamond Services International (P.) Ltd. v. UOI [2008] 169 Taxman 201 (Bombay) wherein the Bombay High Court has made a distinction between a payment made for the use or right to use experience as against a payment made for the application of experience to a certain factual situation.** following the aforesaid reasoning of the Bombay High Court, the **Hyderabad Tribunal in GVK Oil & Gas Ltd. (supra)** has taken a favourable view [see (iv) above]

C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION
24. Adverse case laws

- The relevant factors for determining whether or not, payment for online access to non-customised database amounts to royalty, on the basis of various judicial precedents, which are enumerated in paragraph 8.1 above, have not been considered in the decision of ONGC Videsh Limited (supra).

- **The Bangalore Tribunal decision in the case of Wipro Ltd. (supra)** [which in a way is now **impliedly approved by the Supreme Court** in Engineering Analysis Centre of Excellence (P.) Ltd. (supra)] was **wrongly distinguished on facts,** on the ground that in the case of Wipro Ltd. (supra) [unlike as in **ONGC Videsh Limited (supra)],** the **information in the database was in public domain; whereas the Bangalore Tribunal has not given any weightage to the said fact** (as evident from paragraph 5 of the said decision) and have decided that the payment for online access to database was not royalty in light of the **factors enumerated in slide no 45 above**. Further, it may also be possible to contend that in the case of **ONGC Videsh Limited - a non-inclusive right i.e. an exclusive right** was granted and that the said decision would not be applicable in case of an online access to a non customised/ non-exclusive database.



C] Impact of SC in Engineering Analysis on payment for DATABASE SUBSCRIPTION

25. Conlusion

As clearly evident from the above rulings, the **principles applicable for determining the taxability of payment made for purchase of a computer software would be equally applicable to payments made for** online access to a computer database (since computer software and computer database both fall within the definition of 'literary work' under section 2(o) of the Copyright Act, 1957) and therefore, in my view, the judgement of **Hon'ble Supreme Court in Engineering Analysis Centre** of Excellence (P.) Ltd. v. CIT (supra) would be equally applicable for determining the taxability of consideration / fees / charges paid to access an online computer database.

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

26. Provisions- Explanations 2 and 4 and Article 12(3) of India- Singapore DTAA

"Explanation 2.—For the purposes of this clause, **"royalty" means consideration** (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") **for—**

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

26. Provisions- Explanations 2 and 4 and Article 12(3) of India- Singapore DTAA

(v) **the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work** including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v)."

Explanation 4.— For the removal of doubts, it is hereby clarified that the **transfer of all or any rights** in respect of any right, property or information **includes** and has always included transfer of all or any right for **use or right to use a computer software (including granting of a licence)** irrespective of the medium through which such right is transferred.

Exp 4 – not independent – to Sc r.r. Exp. 2

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

26. Provisions- Explanations 2 and 4 and Article 12(3) of India- Singapore DTAA

Article 12(3) of the India-Singapore DTAA is reproduced hereunder:

"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 :

(a) any **copyright of a literary, artistic or scientific work**, including cinematograph film or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information ;

(b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8."

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

27. Meaning of Copyright for purpose of Explanation 2

i. With regard to the term "**copyright"** which is **neither defined in the Act nor DTAA,** the Hon'ble Supreme Court has observed that the expression "copyright" has to be understood in the context of the **statute which deals with it**, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA [See para 100 of the said judgement].

ii. After considering the provisions of **section 16, 14, 2(y), 2(O), 2(ffc), 30 and 52 of the Copyright Act,** 1957, in paragraph 33 of the said judgement, (which is reproduced in Annexure II(a) to this written opinion), the Hon'ble Supreme Court has held in **paragraph 36 that the right to reproduce a computer software programme and exploit the reproduction by way of sale, transfer, license etc. is at the heart of the copyright.**

iii. The Hon'ble Supreme Court observed that there is a **difference between 'right to reproduce' and 'right to use', in as much as that under right to reproduce, there would be a parting of the copyright by the owner thereof, whereas in case of right to use, there would not be parting of any copyrights.**

iv. "**64….. transfer of all or any rights in relation to copyright is a sine qua non under explanation 2 to section 9(1)(vi)** of the Income Tax Act. In short, there must be transfer by way of licence or otherwise, of all or any of the rights mentioned in section 14(b) read with section 14(a) of the Copyright Act.

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

27. Meaning of Copyright for purpose of Explanation 2

v. 72. …. there must, …… be a transfer of any of the rights contained in sections 14(a) or 14(b) of the Copyright Act, for explanation 2(v) to apply. **To this extent, there will be no difference in the position between the definition of "royalties" in the DTAAs and the definition of "royalty" in explanation 2(v) of section 9(1)(vi) of the Income Tax Act.**

Vi. 73 Even if we were to consider the ambit of "royalty" only under the Income Tax Act on the footing that none of the DTAAs apply to the facts of these cases, the definition of royalty that is contained in explanation 2 to section 9(1)(vi) of the Income Tax Act would make it clear that there has to be a transfer of "all or any rights'' which includes the grant of a licence in respect of any copyright in a literary work. **The expression "including the granting of a licence" in clause (v) of explanation 2 to section 9(1)(vi) of the Income Tax Act, would necessarily mean a licence in which transfer is made of an interest in rights "in respect of" copyright,** namely, that there is a parting with an interest in any of **the rights mentioned in section 14(b) read with section 14(a) of the Copyright Act. To this extent, there will be no difference between the position under the DTAA and explanation 2 to section 9(1)(vi) of the Income Tax Act.**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)
27. Meaning of Copyright for purpose of Explanation 2

vii. 96. **The AAR then reasoned that the fact that a licence had been granted would be sufficient to conclude that there was a transfer of copyright,……**

by referring to explanation 2 to section 9(1)(vi) of the Income Tax Act. It then held:

……

So, when a copyrighted article is permitted or licensed to be used for a fee, the permission involves not only the physical or electronic manifestation of a programme, but also the use of or the right to use the copyright embedded therein."…..

viii. Thus, the conclusion that when computer software is licensed for use under an EULA, what is also licensed is the right to use the copyright embedded therein, is wholly incorrect……

ix. The reasoning of this judgment also does not commend itself to us. ….. **no distinction was made between computer software that was sold/licensed** on a CD/other physical medium and the parting of copyright in respect of any of the rights or interest in any of **the rights mentioned in sections 14(a) and 14(b) of the Copyright Act.**

x. Thus, as evident from above, **transfer of rights mentioned in section 14(b) read with section 14(a) of the Copyright Act, 1957 is a sine qua non for taxability of software as copyright under Explanation 2 to section 9(1)(vi)** of the Act and that the right to reproduce a computer software programme and exploit its reproduction by way of sale, transfer, license etc. is at the heart of the copyright.

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

i. **As self-evident from Explanation 4 to section 9(1)(vi) of the Act, the same does not provide that the consideration for sale of a computer software would amount to Royalty.**

ii. It merely **provides** that "….the **transfer of all or any rights** in respect of any right, property or information includes and **has always included transfer of all or any right for use or right to use a computer software (including granting of a licence)** irrespective of the medium through which such right is transferred."

iii. It would be pertinent to note that the Hon'ble Supreme Court at paragraph 76 of the aforesaid decision has held that "…….explanation 4 was inserted retrospectively to expand the scope of explanation 2(v). In any case, explanation 2(v) contains the expression, 'the transfer of all or any rights' which is an expression that would subsume 'any right, property or information' and is wider than the expression 'any right, property or information'.

iv. Thus, **what logically follows** from the above is that the **"rights" referred to in Explanation 2 to section 9(1)(vi) of the Act is wide enough to include "right for use or right to use a computer software (including granting of a license)".**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

v. In light of the above, if Explanation 2 to section 9(1)(vi) of the Act is read together with Explanation 4 to section 9(1)(vi) of the Act, as indicated by the Hon'ble Supreme Court above, explanation 2(v) to section 9(1)(vi) of the Act would read as under

["the transfer of all or any rights"] including ["transfer of all or **any right** for use or right **to use a computer software (including granting of a licence)"]** ["in **respect of any copyright**, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting 11[, but not including consideration for the sale, distribution or exhibition of cinematographic films"].

Note: [I may also humbly point out that the provisions contained in **Explanation 2(v)** to section 9(1)(vi) of the Act, in any case, are **not well drafted** which fact is also recognized by the Hon'ble Supreme Court in **paragraph 70** of the said judgement]

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

vi. Thus, notwithstanding the insertion of Explanation 4 to section 9(1)(vi) of the Act, as evident from above, consideration for transfer of **rights to use** or rights for use of a **computer software would amount to royalty within the definition of royalty under explanation 2 clause (v) to section 9(1)(vi)** of the Act, **only if** the same is in respect of a copyright, meaning thereby the same is **accompanied with the rights specified under section 14(a) and section 14(b) of the Copyright Act, 1957** i.e. **mainly the right to reproduce copies of the computer software for commercial exploitation** by sale thereof. In the absence of the aforesaid right, in my view, the transfer of right to use or right for use software would be outside the purview of the definition of royalty under Explanation 2 clause (v) read with Explanation 4 to section 9(1)(vi) of the Act.

vii. Mere introduction of the term "computer software" in the definition of "royalty" in the Act may not be of no consequence in the above scenario.

viii. "156…… As a matter of fact, DTAAs that were amended subsequently, such as the Convention between the Republic of India and the Kingdom of Morocco for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes On Income, **["India-Morocco DTAA"], which was amended on 22.10.2019,~~49~~ incorporated a definition of royalties, not very different from the definition contained in the OECD Model Tax Convention, as follows:**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

"The term **"royalties"** as used in this Article means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or recordings on any means of reproduction for use for radio or television broadcasting, any patent, trade mark, design or model, plan, **computer software programme,** secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment"

(Article 12.3)"

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

CIT v. Vinzas Solutions India Private Limited (2017) 392 ITR 155 (Madras)

a. while dealing with the applicability of **section 194J** of the Act (which interalia requires the payer to deduct tax at source from any sum in nature of 'royalty' as defined in Explanation 2 to section 9(1)(vi) of the Act), the court **held that the provisions of section 9(1)(vi) of the Act was not applicable in case of payment made for purchase of a computer software as the transaction was merely in nature of sale of 'copyrighted article' and not the sale / transfer of the copyrights in the computer software.**

b. Further, the **High Court also held that Explanation 4 to section 9(1)(vi) of the Act would have to be read and understood in the context that only in a case when there is sale / transfer of the copyrights in the computer software, the transaction would fall within the purview of section 9(1)(vi) of the Act and not when there is merely a sale / transfer of 'copyrighted article'.**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

PCIT v. M-Tech India Pvt. Ltd. (2016) 381 ITR 0031 (Delhi),

Wherein the court held:

"2. In its appeal, the Revenue has projected the following questions of law:-
"2.1 Whether in the facts and circumstances of the case, ITAT was justified in law in overlooking explanation 2, 4, 5 to section 9(1)(vi) of the Income Tax Act, 1961?" …….

12. …… It is well settled that where software is sold as a product it would amount to sale of goods. ……

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.

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

PCIT v. M-Tech India Pvt. Ltd. (2016) 381 ITR 0031 (Delhi),

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….

15…

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."

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

28. Conjoint reading of Explanation 2 and Explanation 4

a. Delhi High Court in **M-Tech India Pvt**. Ltd. (supra) while holding that payment for purchase of a computer software would not fall within the purview of 'royalty', has observed at paragraph 12 that *"In **the cases where an Assessee acquires the right to use a software, the payment so made would amount to royalty……."**.*

b. The said observation of the Delhi High Court is **not the ratio decidendi** as in the case before the Delhi High Court, **software was not purchased for 'use' but the same was purchased for trading purposes.** Thus, the aforesaid observation, in my view, would **not** have a **binding force of a precedent, being obiter in nature.**

c. In any case**, it is submitted that the said observation is incorrect and contrary to what has been held by the Supreme Court** in Engineering Analysis Centre or Excellence (P.) Ltd. (supra). (reference may be made to paragraphs 50, 97, 114, 115 and 117 of the aforesaid judgement

Note: It is pertinent to note that the **Departmental appeals** filed before the Supreme Court in both the abovementioned cases, are **withdrawn due to low tax effect.** [Refer CIT v. Vinzas Solutions India Private Limited Civil Appeal No(s).9784 of 2018 (SC)]

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

29. Impact of Intention of Legislature for enacting Explanation 4

I. CIT v. Vatika Township (P.) Ltd. [2014] 49 taxmann.com 249 (SC)

Wherein the court held:

"49(c).....At the same time, **it is also mandated that there cannot be imposition of any tax without the authority of law. Such a law has to be unambiguous and should prescribe the liability to pay taxes in clear terms. If the concerned provision of the taxing statute is ambiguous and vague and is susceptible to two interpretations, the interpretation which favours the subjects, as against there the revenue, has to be preferred. .....**

Tax laws are clearly in derogation of personal rights and property interests and are, therefore, subject to strict construction, and any ambiguity must be resolved against imposition of the tax. In Billings v. U.S. [1914] 232U.S. 261, the Supreme Court clearly acknowledged this basic and long-standing rule of statutory construction:

"Tax Statutes... should be strictly construed, and, if any ambiguity be found to exist, it must be resolved in favor of the citizen.....

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

29. Impact of Intention of Legislature for enacting Explanation 4

I. CIT v. Vatika Township (P.) Ltd. [2014] 49 taxmann.com 249 (SC)

Wherein, the court held:

Again, in United States v. Merriam [1923] 263 U.S. 179, the Supreme Court clearly stated at pp. 187-88:

" …… If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. Gould v. Gould , 245 U.S. 151,153"

As Lord Cairns said many years ago in Partington v. Attorney-General [1869] LR 4 HL 100: "As I understand the principle of all fiscal legislation it is this : **If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."**

II. CIT v. JV Kolte [1999] 235 ITR 239 (Bombay)

Wherein, the court held:

"…Law is well settled that **in construing fiscal statutes and in determining the liability of a subject to tax one must have regard to the strict letter of the law and not merely to the spirit of the statute** or the substance of the law….. If the case is not covered within the four corners of the provisions of the taxing statute, no tax can be imposed by inference or by analogy or by trying to probe into the intentions of the Legislature"

III. CIT v. Motors & General Stores (P.) Ltd. [1967] 66 ITR 692 (SC)

Wherein, the court held:

"….If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

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IV. CIT v. Provident Investment Co. Ltd. [1957] 32 ITR 190 (SC)

Wherein, the court held:

"The second point is that in construing fiscal statutes and in determining the liability of a subject to tax, one must have regard to the strict letter of the law and the true legal position arising out of the transaction in question."

IV. A.V. Fernandez v. State of Kerala [1957] 8 Sales Tax Cases 561

Wherein, the court held:

"If the Revenue satisfies the Court that the case falls strictly within the provisions of the law, the subject can be taxed. If, on the other hand, the case is not covered within the four corners of the provisions of the taxing statute, no tax can be imposed by inference or by analogy or by trying to probe into the intentions of the legislature and by considering what was the substance of the matter."…..

VI. CIT v. Ajax Products Ltd. [1965] 55 ITR 741 (SC)

Wherein the court held:

"The respondent-assessee, the Ajax Products Ltd…..

at an extraordinary general body meeting, made a resolution to go into voluntary liquidation and the liquidator appointed by the said resolution, carried on the business till the, middle of December, 1954, when the business was completely closed down. On March 10,1955, the liquidator executed a sale deed to Carborundum Universal Limited transferring to the latter the plant,machinery and buildings for a sum of Rs. 10,00,000.
…….

The relevant assessment year is 1956-57 and the corresponding accounting year is the calendar year 1955.

VI. CIT v. Ajax Products Ltd. [1965] 55 ITR 741 (SC)

….. learned counsel for the revenue raised before us two points:

The second question raised before us turns upon the relevant provisions of the Income-tax Act. The relevant provisions read :

It is, therefore clear that if the amendment was not there, the present case is directly covered by the said two decisions as…..

Would the amendment make any difference in the application of the proviso? The rule of construction of a taxing statute has been pithily stated by Rowlatt J. in Cape Brandy Syndicate v. Inland Revenue Commissioners [1921] 1 K.B. 64, 71 thus :

"In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used".

VI. CIT v. Ajax Products Ltd. [1965] 55 ITR 741 (SC)

The fiction in the second proviso is a limited one…… It was given a limited meaning under the earlier decisions. **To sustain the argument of the revenue, it has to be enlarged in its cope. Many words have to be read into it which are not there. We cannot accept this argument.**

…….

Indeed the expressed intention of the legislature is the other way. We therefore hold that the amendment only removed one of the conditions for the exigibility ….

the construction put upon the proviso by the earlier decisions of this court is still good law.

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

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VII. Jindal Thermal Power Co. Ltd. v. DCIT [2009] 182 Taxman 252 (Kar)

"6… **Sri Mohan Parasaran referred to Memorandum explaining the provisions in the Finance Bill, 2007……**

Sri Mohan Parasaran argued that the explanation incorporated by way of amendment to section 9(2) is to overcome the legal lacuna pointed out by Supreme Court in Ishikawajma Harima Heavy Industries Ltd.'s case (supra).

When the purport of the Explanation to section 9(2) is plain in its meaning, it is unnecessary and impermissible to refer to the Memorandum explaining the Finance Bill, 2007. **Therefore, it is explicit from the reading of section 9(1)(vii)(c) and Explanation to section 9(2) that the ration laid down by the Supreme Court in Ishikawajma Harima Heavy Industries Ltd.'s case (supra) still holds the field"…**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

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viii. Further, it is well settled that a deeming provision or a provision which enacts a legal fiction (i.e. section 9 of the Act in the present case) should be strictly construed. Reference may be made to **Shekhawati General Traders Ltd. v. ITO [1971] 82 ITR 788 (SC), CIT v. Khimji Nenshi [1991] 59 Taxman 278 (Bombay), CIT v. P.K. Kaimal [1980] 4 Taxman 319 (Madras) and CIT v. Bhupender Singh Atwal [1983] 13 Taxman 254 (Calcutta)**

D] Impact of SC in Engineering Analysis on taxability of software under Explanation 4 to Section 9(1)(vi)

30. Conclusions and suggestions

i. In light of the above, **it may be possible to strongly contend that, payments made for purchase of a computer software would not be taxable as 'royalty' on a strict / literal interpretation of the deeming / charging provisions of** section 9(1)(vi) of the Act read with Explanation 2 and Explanation 4 thereto (as elaborated in paragraphs 5 and 6 above) **notwithstanding the intention of the Legislature, since the said intention is not reflected in the express provisions of Explanation 4** read with Explanation 2 to section 9(1)(vi) of the Act by clear / unambiguous words or language.

ii. **However, merely because the Hon'ble Supreme Court has also held that Explanation 4 to section 9(1)(vi) of the Act expands the definition of 'royalty'** given under Explanation 2 to section 9(1)(vi) of the Act and that Article 12 containing the definition of 'royalty' under the DTAA's is more beneficial than the definition contained in the Act, in my view, in light of the detailed reasoning given above, it may not be legally permissible for the Revenue to try and deduce / infer that post the insertion of Explanation 4 to section 9(1)(vi) of the Act by the Finance Act, 2012, payments made for the purchase of off-the-shelf / shrink wrapped computer software, would be taxable as 'royalty' under explanation 4 read with explanation 2 to section 9(1)(vi) of the Act, even if the same is unaccompanied with the right to reproduce the computer software. Reference may also be made to **State of Haryana v. Ranbir (2006) 5 SCC 167,**

"13. **…A decision, it is well-settled, is an authority for what it decides and not what can logically be deduced therefrom."**

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Suggestions

i. **It may be possible to strongly contend t**hat the payments made for the purchase of off-the-shelf / shrink wrapped computer software, without transferring the right mentioned under section 14(a) and 14(b) of the Copyrights Act, 1957 (i.e. mainly the right to reproduce the computer software programme), would not be taxable as 'royalty' under Explanation 4 read with Explanation 2 to section 9(1)(vi) of the Act.

ii. It would be **advisable to comply with the withholding tax obligations** under the Act by withholding taxes at source u/s 195 of the Act at the first instance and then the said assessee may considering filing an **appeal under section 248** of the Act. Or **resort to provisions of section 195(2) or section 197 of the Act.**

iii. The **non-resident** receiving income from sale of shrink wrapped computer software, who takes the above position and claims that the said income is not taxable in India under section 9(1)(vi) of the Act, he should **disclose the said position in its return of income** by way of a disclosure (or by way of a separate letter as the procedure permits) and **pay the advance tax** on the same and **claim the refund.**

iv. For **domestic transactions** of purchase of shrink wrapped computer software which is not accompanied with the rights mentioned under section 14(a) and 14(b) of the Copyright Act, 1957 (i.e. mainly the right of reproduction of the computer software), **it may also be possible to argue that unlike the provisions of Explanation 2 to section 9(1)(vi) of the Act, provisions of Explanation 4 to section 9(1)(vi) of the Act are not applicable to section 194J** of the Act, in the absence of a specific reference to the same in section 194J of the Act (**see Sonata Information Technology Ltd v. DCIT - (2012) 33 CCH 0117Mum Trib)**

THANK YOU

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