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Payment for software licensed to foreign HO and used by Indian branch with non-exclusive rights isn't 'royalty'

Summary – The Mumbai ITAT in a recent case of Antwerp Diamond Bank NV Engineering Centre., (the Assessee) held that where assessee, a Belgium based bank, having obtained a licence to use software, allowed its Indian branch to use same software by making it accessible through server located at Belgium, amount reimbursed by branch on pro rata basis for use of said resources was not liable to tax in India as royalty under section 9(1)(vi) or article 12(3) of India-Belgium DTAA.

Facts

- The assessee was a bank incorporated in Belgium and was a tax resident of Belgium. The assessee was operating through branch in India.
- The assessee had acquired its main banking application software from an Indian software company. Later on, when the branch was setup in India, the software license was amended to allow the branch to use same software by making it accessible through the server located at Belgium.
- Since the branch was using the I.T. resources situated at Belgium and paid by the Head Office, the branch reimbursed the Head Office the cost of the data processing on pro rata basis for the use of the said resources.
- In the course of assessment, the Assessing Officer opined that the nature of expenses goes to show that the assessee was providing services to the Indian Branch which was in the nature of 'royalty' as defined in sub-clause (*iv*) to *Explanation* 2 to section 9(1)(*vi*). He also referred to the definition of 'royalty' given in article 12(3) of DTAA and held that such a payment made by the Branch to the Head Office was on account of services which were in the nature of commercial or scientific knowledge.
- Thus, the Assessing Officer concluded that the payment was in the nature of 'royalty' and the assessee was required to deduct the tax in accordance with the provisions of section 195.
- In view of failure of assessee to deduct tax at source, the Assessing Officer disallowed the entire payment under section 40(*a*)(*i*).
- The Commissioner (Appeals) was of view that the data processing cost paid by the assessee to the Head Office did not amount to 'royalty' and, hence, there was no liability to deduct tax at source Consequently, disallowance made under section 40(*a*)(*i*) was deleted.
- On revenue's appeal:

Held

- As per the terms of agreement between the Branch and the Head Office for the usage of software by the Branch, it is evident that the Head Office only has the non-exclusive non-transferrable rights to use the computer software brought for personal use and clause 16 of the said agreement specifically provides that the Head Office does not have any right to assign, sub-license or otherwise transfer the license of this agreement.

- Thus, the payment by the Branch for use of computer software is not the right in the copy right but only for doing the work from the said software which subsists in the copy right of the software. The branch is using the computer software and the I.T. resources installed at Belgium for which the payment is made by the Head Office towards the use of such software license.
- Since the Branch is using the same software for the purpose of business operations, the Head Office allocates the said expenditure on a pro rata basis for the use of the said resources which is being reimbursed by the Branch to the Head Office. It is not in dispute that the assessee has sought the benefit of treaty between India and Belgium and had specifically relied upon the definition of 'royalty' as given in the clause (*a*) of Para-3 of article-12 of DTAA.
- The definition of 'royalty' in said article provides that, when the payment of any kind is received as a consideration for 'use' of or 'the right to use' of any of the copy right of any item or for various terms used in the said article, then only it can be held to be for the purpose of 'royalty'. The said definition of 'royalty' is exhaustive and not inclusive and, therefore, it has to be given the meaning as contained in the article itself and no other meaning should be looked upon.
- If the assessee is claiming the application of the DTAA, then the definition and scope of 'royalty' given in the domestic law, in the present case, section 9(1)(*vi*) should not be read into or looked upon. The character of payment towards royalty depends upon the independent 'use' or the 'right to use' of the computer software, which is a kind of copy right.
- In the present case, the payment made by the Branch is not for 'use' of or 'right to use' of software which is being exclusively done by the Head Office only, installed in Belgium. The Branch does not have any independent right to use or control over such main frame of the computer software installed in Belgium, but it simply sends the data to the Head Office for getting it processed.
- Insofar as the Branch is concerned, it is only reimbursing the cost of processing of such data to the Head Office, which has been allocated on pro rata basis. Such reimbursement of payment does not fall within the ambit of definition of 'royalty' within the article 12(3)(*a*). To fall within its ambit, the Branch should have exclusive and independent use or right to use the software and for such usage, payment had to be made in consideration thereof.
- It is not the case of the revenue that the Head Office has provided any copy right of software or any copyrighted article developed by the Head Office for the exclusive use of the assessee for, which the assessee is making the payment along with the mark-up exclusively for the purpose of royalty. If the payment for license for the software which is installed in the Head Office is being made by the Head Office, then any allocation of cost and reimbursement thereof by the Branch to the Head Office cannot be termed as independent payment for the purpose of royalty.
- To fall within the ambit of 'royalty' under article, the payment should be exclusively *qua* the use of the right to use the software exclusively by the Branch. The character of the payment under the royalty transactions depends upon the rights that the transferee acquires in relation to the use and exploitation of the software programme. Here, there was no such right which had been acquired by the Branch in relation to the usage of software, because the Head Office alone had the exclusive

right of the license to use the software. Thus, the reimbursement of the data processing cost to the Head Office did not fall within the ambit of definition of 'royalty' under article 12(3)(*a*).

- Thus, in view of the aforesaid, it is held that the impugned payment made by the Branch to the Head Office towards reimbursement of cost of data processing cannot be held to be covered within the scope of expression 'royalty' under article 12(3)(*a*) of the India-Belgium DTAA. Accordingly, the conclusion drawn by the Commissioner (Appeals) is affirmed.
- Since the data processing cost paid by the assessee does not amount to royalty, consequently, there is no requirement for deducting tax at source on such payment. Therefore, the provisions of section 40(*a*)(*i*) will not apply.
- In the result, the revenue's appeal is dismissed.