

Software payments can't be held as royalty if payer doesn't have any right of modification: ITAT

Summary – The Mumbai ITAT in a recent case of AVEVA Information Technology India (P.) Ltd., (the Assessee) held that where assessee, an Indian company entered into a software license agreement with a British company, since said agreement did not permit assessee to modify and develop software products and UK company was sole owner of IPR of patents, copyrights and trademarks and assessee was not given any of these proprietary rights, payments by assessee to ASL for procuring and distributing copyrighted software could not be treated as payment towards royalty

Facts

- The assessee had entered into a distribution agreement with a British company, ASL to distribute the software products developed by said company to the customers within the territory of India. The perusal of the agreement indicate that the assessee was granted a 'non-exclusive' and 'non-transferable' license to market and distribution the software products developed by ASL to end customers. The assessee did not have any right to the source code of software products and was not permitted to modify the software products, including the documentation. ASL was the sole owner of IPR of the patents copyrights trademarks modifications and updates and assessee was not given any of these proprietary rights by ASL. The assessee would be purchasing the license for software products from ASL and would distribute it to end-customers, that the end-customers would pay sub-licensing fee to the assessee.
- The Assessing Officer and the FAA held the assessee was in receipt of royalty as the payments made by it to ASL for the distribution of software products would qualify as royalty in the hands of ASL, as per the *Explanation 2* to section 9(1)(vi) as well as the provisions of article 13 of the India UK tax treaty.
- On the other hand, the assessee claimed that payment made by it could not be treated as royalty.
- On appeal:

Held

- ASL-UK company did not have any PE in India in terms of article 5 of the treaty. Article 13 of the treaty defines the term royalty. From which it is clear that consideration paid for the use of/the right to use the copyright of any scientific work etc. would qualify as royalty. In other words if the payment is not for intellectual properties such as copyright, patents trademarks etc., the payment cannot be treated as royalty. The assessee had acquired right to sell the copyrighted article (software products) and not the right to use the copyright.
- Here, hence is also made to *Explanation 2* to section 9(1)(vi) wherein royalty has been defined. As per the definition term royalty envisages payment for transfer of all or any rights in intellectual properties (such as copyrights, patents etc.) by the owner of such intellectual property by any other

person. It is clear that the Act does not contain a definition of such intellectual properties that are included within the scope of term royalty.

- A retrospective amendment has been made to *Explanation* to section 9(1)(vi) by Finance Act, 2012. The Finance Act, 2012 inserted *Explanation 4* to the section 9(1)(vi) with retrospective effect from 1-6-1976. From the amendment it is clear that it covers the transfer of all or any right for use/right to use of computer software including grant of licence. The amendment has been made to the section *i.e.*, to domestic law. But, there is no corresponding change in Tax Treaty. It is also to be remembered that the assessee had already made the payment before the amendment was introduced. At the point of making payment to ASL, the assessee was not liable to deduct tax at source. So, now it cannot be compelled to deduct tax. The basic principal of taxation stipulates that nobody is supposed to perform the impossible. In the case of *B4U International Holdings Ltd. v. Dy. CIT (IT)* [\[2012\] 21 taxmann.com 529/52 SOT 545 \(Mum.\)](#) the Tribunal had held that there is no change in the DTAA between India and USA.
- Similar is the position of Indo-UK DTAA, where term royalty has not been defined. Considering same, the definition of term royalty as appearing in the India UK DTAA apply and amendments made by Finance Act, 2012 would have no bearing on the present case. In the instant case, the DTAA is providing particular mode of computation for royalty. As per the agreement the assessee did not have any right to generate the license key or make copies of license key or was provided access to source code in the software. The ASL software products were developed and marketed by it were in the nature of Ashrink-wrap-software-products that are also known as off the shelf software products. The assessee had no role in developing a software, it was just distributing the software to the end users. Therefore, payment by the assessee to ASL for procuring and distributing copyrighted software on principal to principal basis could not be treated as payment towards royalty. ASL was not having a PE in India, therefore, the assessee was not liable to deduct tax at source as per the provision of section 195.