Sale consideration of copyrighted software couldn't be taxed as royalty: Mumbai ITAT

Summary – The Delhi ITAT in a recent case of Micro Focus Ltd., (the Assessee) held that Consideration received by assessee from various entities on account of sale of software was not royalty within meaning of Article 13 of India UK DTAA

Facts

- The assessee-company was engaged in the business of development and distribution of software products in India, either through its distributors or directly to the customers. The assessee entered into contracts with its customers on principal to principal basis and sale of software licenses was concluded outside India (offshore supplies).
- The Assessing Officer held that consideration received by the assessee from various entities on account of sale of software was royalty within the meaning of article 13 of the India UK DTAA.
- The Commissioner (Appeals) allowed the appeal of the assessee.

Held

- The Distributor Agreement gives non-exclusive right to only distributor to market and distribute the software products to third parties throughout the territory. Distributor will act as independent contractor only and will neither act on behalf of assessee nor purport to represent assessee in any way. Thus, the assessee submitted that the consideration received by it from the customers in India towards offshore supply of software could not be chargeable to tax in India under the Act read with India UK Tax Treaty. The assessee entered into contracts with its customers on principal to principal basis and the sale of software licenses was made outside India; no portion of sale was carried out in India and the payment is made directly by the customers to the bank account in United Kingdom. It is pertinent to note that the Assessing Officer has referred this distributor agreement but has not taken cognizance of the clause of these agreements. The submissions made by the assessee clearly set out what are the effects of this distribution agreement. In view of section 90(2), the assessee opts for Double Taxation Avoidance Agreement between India and UK to override the provisions of the Act as there is no corresponding amendment to the definition of the term 'royalty' in article 13(3) of the aforesaid DTAA as carried out in the definition of royalty under section 9 (1)(6). The amendment will not be applicable. The Income represents business income of assessee outside India and should be covered under the definition of royalty. In absence of any permanent established in India, the same would not be chargeable to tax in India in Article 7 of India UK Tax Treaty. Further, the same cannot be treated as royalty income under the Act or India-UK Tax Treaty.
- The assessee is only selling copyrighted article and there is no payment for use of copy right or acquiring the right to use the copyright and, hence, the same is not covered within the definition of

royalty in DTAA. It is the separate position that the payment made for the use of copyrighted article should be treated as business income and not the royalty income.

- Thus, the issue relating to the consideration received by the assessee from various entities on account of sale of software is not royalty within the meaning of Article 13 of the India UK DTAA, the effect of Article 3(2) of DTAA clearly set out the definition of royalty as per the distributor agreement and the end user license agreement which was produced before the Assessing Officer as well as before the CIT(A). The DRP has not taken into account the correct and true meaning of the royalty and the services do not come under the purview of royalty. In result, appeal filed by the Revenue is dismissed.