Sum paid for use of computer software not royalty in absence of amendment to definition of royalty in DTAA

Summary – The Mumbai ITAT in a recent case of Agfa Healthcare N.V., (the Assessee) held that In absence of a provision similar to Explanation 4 to section 9(1)(vi) making amendment in definition of royalty in India-Belgium DTAA, payment made for use or right to use of computer software cannot be treated as royalty under India Belgium tax treaty

Payment received by assessee, a Belgian company, from Indian company towards sale of software is not in nature of royalty

Facts

- The assessee, a Belgian company, was in the business of production and sale of health and digital imaging solutions. It had earned income from provision of ICS to its Indian Group company, (AHIPL) during the relevant previous year, however, it had not offered same to tax such income.
- Though the Assessing Officer agreed with the assessee that the receipts from ICS could not be treated as FTS as per article 12(3)(b), read with clause-1 of the Protocol to the India - Belgium Tax Treaty, however, he held that the amount received from AHIPL for provision of ICS was in relation to use of computer software and/or for the use of process or for rendering of services in relation to those items and referring to *Explanation* 4 to section 9(1)(vi), he observed that as per the said *Explanation* transfer of right to use a computer software would come within the purview of royalty as per section 9(1)(vi). Accordingly, he concluded that the amount received from ICS was taxable as royalty both under the Act, 1961 as well as India-Belgium DTAA.
- The DRP observed that the fees paid by AHIPL was not for any on-call service but for utilizing a comprehensive platform developed by the assessee through which AHIPL conducted its business. Thus, the platform provided to the assessee was in the form of a technical plan or process and the assessee had been granted a right to use it. The DRP referring to article-12(3) ultimately concluded that the payment made to the assessee for ICS was in the nature of royalty.
- On appeal:

Held

- A reading of article 12 makes it clear that the payment received for use of or right to use of any copyright of literary, artistic or scientific work including cinematograph films, patent, trademark, design or model, plan, secret formula or process or information concerning industrial, commercial or scientific experience is to be treated as royalty. The aforesaid definition does not refer to transfer of any right for use or right to use a computer software. As per section 9 certain categories of income would be deemed to accrue or arise in India. One such income as per section 9(1)(6) is 'royalty'. In case of a non-resident if the royalty is payable in respect of any right, property or information used

or services utilised for the purpose of a business or profession carried out in India or for the purpose of making or earning any income from any source in India, it will be taxable.

- A reading of the definition of 'royalty' in *Explanation*-2 to section 9(1)(vi) makes it clear that, though the definition of royalty is wider than the definition provided under article 12(3)(a) however, it does not specifically refer to computer software. However, subsequently, by Finance Act, 2012, Explanation-4 was introduced to section 9(1)(vi) with retrospective effect from 1st June, 1976.
- Thus, by virtue of above Explanation, the scope and ambit of the 'term' royalty was further expanded to also include transfer of all or any right for use or right to use computer software irrespective of the medium through which such right is transferred. It is relevant to observe, by referring to *Explanation-4* of section 9(1)(vi) the Assessing Officer has concluded that the amount received by the assessee from ICS is in the nature of royalty, since, such services are in relation to computer software and/or for the use of process or for rendering services in relation to those items. Notably, the aforesaid Explanation-4, though, was introduced to section 9(1)(vi) with retrospective effect from 1st June 1976, however, there is no such corresponding amendment made to the definition of 'royalty' in India-Belgium DTAA through introduction of a similar *Explanation* like Explanation-4 to section 9(1)(vi). Therefore, assessee's contention that in the absence of a provision similar to Explanation-4 to section 9(1)(vi) in the India-Belgium DTAA, payment made for use or right to use of computer software cannot be treated as royalty under the tax treaty, requires to be considered objectively and with all seriousness as it has a crucial bearing on the ultimate taxability of the amount received towards ICS. Though, the aforesaid contention was raised by the assessee before the Departmental Authorities, however, they have completely ignored such contention made by the assessee. This is improper and against the principles of natural justice. Further, on a careful scrutiny of the order of the DRP of its finding on the issue of royalty *vis-a-vis* article-13(1)(a) are contradictory. While dealing with the taxability of amount received towards ICS, though, the DRP has observed that the nature of payment is royalty even under article-12(3)(a), however, while dealing with the issue relating to taxability of amount received towards sale of software along with equipment, the DRP has observed that the definition of 'royalty' under the India-Belgium DTAA will not be applicable and the definition of royalty under the Act, after the amendment brought through Finance Act, 2012, would be applicable. Thus, as per the DRP's own finding, there is a distinction between the definition of 'royalty' under the Act and the India-Belgium DTAA. In such circumstances, assessee's contention that the expanded definition of 'royalty' after introduction of Explanation-4 to section 9(1)(vi) would not apply to assessee's case in absence of corresponding amendment in article- 12(3)(a) should have been considered by the Assessing Officer and the DRP. However, neither the Assessing Officer nor the DRP have done such exercise. In view of the aforesaid, the issue is restored to the file of the Assessing Officer for *de novo* adjudication after due opportunity of being heard to the assessee.