IN THE INCOME TAX APPELLATE TRIBUNAL
"SMC" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY (JUDICIAL MEMBER)

I.T.A. No.3011/Mum/2019
(Assessment Year : 2009-10)

M/s Progress Software Solutions India Private Limited, No.18, 4th Floor, 1 Labs Centre, No.8 Software Unit Layout, Madhapur, Hyderabad Telangana – 500 081 PAN : AAACT7450Q	vs	DCIT-13(1)(2), Mumbai
APPELLANT		**RESPONDENT**

Appellant by	Shri Mahaveer Jain , AR
Respondent by	Shri. Ujjawal Kumar , DR

Date of hearing	16-06-2021
Date of pronouncement	30-08-2021

O R D E R

This is an appeal by the assessee against order dated 04-01-2019 of learned Commissioner of Income Tax (Appeals)-21, Mumbai for the assessment year 2009-10.

2. Before I proceed to deal with the disputed issues, it is necessary to recapitulate the relevant facts leading to the filing of the present appeal.

3. Briefly stated, the assessee is a resident company stated to be engaged in business of computer software development, sale of product license on commission and trading in product software license. For the assessment year

under dispute, assessee filed its return of income on 28-09-2009 declaring loss of Rs.89,29,099/-. Assessment in case of the assessee was originally completed u/s 143(3) of the Act vide order dated 26-12-02011 making the following additions / disallowances:-

1. Disallowance under section 40(a)(i) for non deduction of tax on payment made towards purchase of software Rs. 23,50,466/-

2. Disallowance on account of difference of loss on non export Oriented (EOU) unit Rs.48,54,250/-

3. Disallowance under section 36(1)(va) on account of delayed Remittance of employees' contribution to Provident Fund Rs. 6,69,035/-

4. As a result of the aforesaid disallowances, the total loss was determined at Rs.10,55,380/-. Against the assessment order so passed, assessee preferred appeal before learned Commissioner (Appeals). While disposing of assessee's appeal, learned Commissioner (Appeals) granted partial relief by deleting the disallowance oRs,.6,69,035/- made under section 36(1)(va) of the Income Tax Act, 1961. Against the order passed by learned Commissioner (Appeals), the assessee went in further appeal before the Tribunal. The Tribunal, while deciding assessee's appeal in ITA No.3151/Mum/2013 dated 28/09/2016 restored the issues back to the assessing officer for fresh adjudication. Pursuant to the order passed by the Tribunal, the assessing officer passed a fresh assessment order repeating the additions made earlier. Though, assessee contested the additions before learned Commissioner (Appeals); however, it was unsuccessful. Being aggrieved, the assessee is again before the Tribunal.

5. Be that as it may, in grounds 1 and 2 assessee has challenged the disallowance of Rs.23,50,466/- due to non deduction of tax at source on payment made towards purchase of software.

6. Briefly the facts are, in course of assessment proceedings, the assessing officer noticed that the assessee has claimed expenditure of Rs.23,50,466/- towards purchase of computer software products from a non resident company, viz. Savvion, USA. Being of the view that the payment made by the assessee is in the nature of royalty, in terms of section 9(1)(vi) of the Act, the assessing officer called upon the assessee to explain as to why the expenditure claimed should not be disallowed under section 40(a)(i) of the act for non deduction of tax at source. In response to the query raised, assessee furnished detailed submission supported by judicial precedents stating that the payment made is not in the nature of royalty; hence, there is no requirement for deduction of tax at source under section 195 of the Act. The assessing officer, however, did not find merit in the submissions of the assessee. Relying upon the decision of the Hon'ble Karnataka High Court in case of CIT vs Samsung Electronics Co Ltd (2012) 23 taxmann.com 26 and couple of other decisions, he observed that the payment made for supply of even a shrink-wrapped software is in the nature of royalty, since, it is not the price of the CD alone nor software alone nor the price of license granted, but it is a combination of all. He observed, unless a license is granted permitting the end-user to copy and download the software, the CD would not be helpful to the individual. Thus, relying upon some judicial precedents, he concluded that the payment made by the assessee towards purchase of software is in the nature of royalty on which the assessee was required to deduct tax at source under section 195 of the Act. Assessee having failed to do so, the assessing

officer disallowed the amount purportedly under section 40(a)(i) of the Act. The assessee contested the aforesaid disallowance before learned Commissioner (Appeals) without any success.

7. The learned counsel for the assessee submitted, the assessee buys the software from the non–resident company for reselling it to the customers in India and not for self consumption. Drawing our attention to the copy of the reseller agreement placed in the paper book, he submitted, the license granted by the non–resident company, viz. the owner of the software is for the limited purpose of reselling and not for internal use. He submitted, as per the terms of the agreement, neither the assessee nor any third party is permitted to translate, modify, adapt, enhance, extend, decompile, de–assemble or reverse engineer the software program. He submitted, the agreement also makes the assessee liable for any unauthorized disclosure, use or copying of the software program, as, the non–resident company, for all intent and purpose and at all time remains the owner of trademark, service mark and logos relating to the software program. Thus, he submitted, as per the terms of the agreement, the assessee is simply a distributor of a copyrighted article and not the copyright. Thus, he submitted, the payment made to the non–resident company for purchase of software is not in the nature of royalty either under the provisions of India–USA DoubleTaxation Avoidance Agreement (DTAA) or under section 9(1)(vi) of the Act. Further, he submitted, the issue is now settled in favour of the assessee by the decision of the Hon'ble Supreme Court in case of Engineering Analysis Centre of Excellence (P) Ltd vs CIT 432 ITR 471 (SC) wherein the Hon'ble Supreme Court, while dealing with the identical nature of purchase of software for resale under distribution agreement has held that payment made towards purchase of a copyrighted

article for resale/distribution is not in the nature of royalty under Article 12 of the Indo–USA tax treaty. He submitted, the decisions relied upon by the assessing officer had been set aside by the Hon'ble Supreme Court while deciding the issue in favour of the assessee. Thus, he submitted, the disallowance should be deleted.

8. Learned departmental representative strongly relying upon the observations of the assessing officer and learned Commissioner (Appeals) submitted, as per the provisions of section 195 of the Act, the assessee was required to deduct tax at source while making payment in the nature of royalty. Thus, he submitted, the addition made should be sustained.

9. I have considered rival submissions and perused materials on record. A reading of the impugned assessment order would make it clear that primarily relying upon the decision of the Hon'ble Karnataka High Court in case of Samsung Electronics Co Ltd and couple of other decisions, the assessing officer has concluded that payment made towards purchase of software, whether off the shelf or otherwise, is in the nature of royalty; hence, requires deduction of tax at source under section 195 of the Act. Learned Commissioner (Appeals) has also endorsed the aforesaid reasoning of the assessing officer without much deliberation. It appears, the departmental authorities have come to their respective conclusion without properly examining the relevant facts relating to the purchase of software by the assessee and have been completely swayed away by the ratio laid down in certain judicial pronouncements. Therefore, it is necessary to examine the relevant facts.

10. Undisputedly, assessee has paid the amount of Rs.23,50,466/- to a US based company towards purchase of computer software. The issue, which requires to be examined is, whether the assessee had made the payment towards

purchase of a copyrighted article for resale in India or a copyright for use according to its own will and convenience. In this regard, it is necessary to look into the agreement between the assessee and Savvion, USA, termed as "Reseller/VAR (value added resolution) agreement". As per the terms of the agreement, software program means, the commercially available object coded software product as specified in Exhibit "A" to the agreement. A reference to Exhibit "A" indicates the product, i.e. on "Savvion business manager". Thus, the assessee has been authorized to resale the aforesaid software product to customers in India. Further, the aforesaid agreement authorizes the assessee as a reseller to enter into end user license agreement (EULA) with end-user. The agreement specifies that the license granted under the agreement is not for internal use of the reseller. Further, clause 2.2 of the agreement restricts the reseller and any third party not to translate, modify, adapt, enhance, extend, decompile, de–assemble or reverse engineer the software program. As per clause 5(b) of the agreement, the assessee, being the reseller acknowledges and agrees that any unauthorized disclosure, use or copying of the software program may cost Savvion,USA serious financial loss; hence, in the event of any unauthorized disclosure, use or copying of the software program, the assessee would be liable for consequential actions and remedies by Savvion, USA. Further, clause 5(c) makes it clear that the assessee has only limited right to use trademark, service mark and logos relating to Savvion, USA or the software program solely in connection with distributing the software program in terms with the agreement. Whereas, ownership of such trademark, service mark and logos relating to the software program will always remain with Savvion, USA.

11. Thus, the aforesaid terms of the agreement make it clear that the assessee is purely a distributor/reseller of a shrink-wrapped/off the shelf software having no right to make any value addition. Any unauthorized use of the software license / product would expose the assessee to legal consequences. Thus, what the facts on record reveal is, the assessee has purchased for distribution a copyrighted article. The assessee had not purchased any copyright either for its internal use, consumption or resale. It is also evident, the computer software purchased by the assessee is not a customized product for a particular customer in India. It is in the nature of a standardized product which can be sold to any person who is willing to buy it. Thus, it is in the nature of a product which can be bought and sold in the open market.

12. Having dealt with the factual position, it is necessary to examine the recent decision of the Hon'ble Supreme Court in case of Engineering Analysis Centre of Excellence (P) Ltd vs CIT (supra) wherein the Hon'ble Apex Court, so to say, has put at rest all controversies relating to the nature of payment made towards purchase of a copyrighted article. A careful reading of the aforesaid judgment of the Hon'ble Apex Court would reveal that after analyzing a number of decisions expressing divergent views, the Hon'ble Supreme Court has observed that where the distribution agreement provides only for a non exclusive, non transferrable license to resale computer software without transferring any copyright in the computer program either to the distributor or to the ultimate end-user and further, stipulating that apart from the right to use computer program by the end-user himself, there is no further right to sub license or transfer or any right to reverse engineer, modify, reproduce anything in any manner otherwise than permitted by license to the end-user, the payment made towards such license is

the price paid to the non–resident manufacturer/supplier for the computer program as goods either in a medium which store the software or in a medium by which software is embedded in hardware. Therefore, the payment made is not towards royalty for use of the copyright in the computer software. Therefore, there is no requirement for deducting tax at source under section 195 of the Act, keeping in view Article 12 of India–USA DTAA. A reading of the aforesaid judgment of the Hon'ble Supreme Court would make it clear that the view expressed by the Hon'ble Karnataka High Court in case of Samsung Electronics Co. Ltd and similar other decisions have not been accepted. If the ratio laid down in Engineering Analysis Centre of Excellence (P) Ltd vs CIT (supra) is applied to the facts of the present case, it will definitely lead to the conclusion that the assessee having paid the amount of Rs.23,50,466/- towards purchase of a copyrighted article for distribution in India without having any right to use the copyright, the payment made is not in the nature of royalty as per Article 12 of India–USA DTAA. Therefore, there is no requirement for deduction of tax at source under section 195 of the Act. That being the case, the disallowance made by the assessing officer and sustained by the learned Commissioner (Appeals) is hereby deleted. These grounds are allowed.

13. In grounds 3 and 4, assessee has challenged the disallowance of loss of Rs.48,54,215/-.

14. Briefly the facts are, in the return of income filed for the impugned assessment year, the assessee had claimed deduction under section 10B of the Act in respect of its export oriented unit (EOU). In course of assessment proceedings, the assessing officer, while examining assessee's claim of deduction observed that the assessee has furnished segmental profit and loss account and a

certificate from the chartered accountant in form 56G. On perusal of the said document, he observed that out of the total turnover of Rs.9,69,53,236/-, the turnover of the EOU is Rs.8,38,77,285/- working out to 86.51% of the total turnover. In other words, the turnover of the non EOU unit is Rs.1,30,75,950/-. On a query to the assessee, it was submitted that employee expenses have been bifurcated on actual basis. However, he alleged that the assessee did not furnish any employee-wise details of work performed and other related activities in respect of EOU and non EOU unit. Further, he observed, the segmental profit and loss account furnished by the assessee bifurcates the salary not on the basis as mentioned in auditor's certificate. Thus, he concluded that the assessee failed to prove that the salary cost has been bifurcated on actual basis. Accordingly, he apportioned the employee related expenses / benefits in proportion of turnover relating to EOU and non EOU unit. Accordingly, he apportioned employee expenses of Rs.5,68,34,060/- to EOU unit which reduced the profit of EOU unit by Rs.3,04,907/-. Similarly, due to apportionment of expenses to non EOU unit in same ratio, the loss got reduced. This resulted in addition of Rs.48,54,215/-. Learned Commissioner (Appeals) also sustained the addition made by the assessing officer.

15. Learned counsel for the assessee submitted that this is the ninth year of claim of deduction under section 10B and in earlier years assessee's claim has been accepted. He submitted, assessee maintain separate books of account for EOU and non EOU units. He submitted, segmental profit and loss account have also been furnished before the assessing officer along with certificate of the auditor. He submitted, the details of staff working in EOU unit was also furnished before the departmental authorities. He submitted, salary paid to some of the

common staff is allocated on turnover basis. Thus, he submitted, when the assessee has maintained separate accounts for EOU and non EOU units and furnished all the necessary details, the salary expenses could not have been apportioned on the basis of turnover. He submitted, the assessing is following the same method of accounting from the earlier years and there was never any issue regarding deduction claimed under section 10B of the Act. Thus, he submitted, the disallowance should be deleted.

16. Learned Departmental Representative relied upon the observations of the assessing officer and earned Commissioner (Appeals).

17. I have considered rival submissions and perused materials on record. It is the claim of the assessee that separate books of account are maintained for EOU and non EOU units. In fact, the assessing officer himself has stated that segmental profit and loss account along with certificate of the auditor has been furnished before him. The dispute is only with regard to the apportionment of salary paid to the staff. It is observed, before the departmental authorities, the assessee had furnished a list of employees working exclusively for the EOU unit, whereas, the assessing officer has alleged that the assessee had not provided any employee-wise details of work performed and other related activities in respect of EOU and non EOU units. Further, the assessing officer has also observed that the assessee has failed to prove that the salary has been bifurcated on actual basis. In case, the assessee is maintaining separate books of account, salary paid to employees of both EOU and non EOU units can be distinctly ascertainable/identifiable from the them, hence, assessee's claim cannot be rejected.

18. After perusing the material on record, I am of the view that the departmental authorities have not properly examined the issue factually.

Therefore, I direct the assessing officer to verify the books of account maintained, both, for EOU and non EOU units and if the salary paid to the employees of both the EOU and non EOU units, is found to be on actual basis as per the separately maintained books of account, no disallowance can be made. Thus, the issue is restored back to the assessing officer for the limited purpose of verifying the salary expenditure as per the separately maintained books of account and computing the deduction under section 10B of the Act. These grounds are allowed for statistical purpose.

19. In ground 5, the assessee has challenged the disallowance of Rs.6,69,035/- under section 36(1)(va) of the Act.

20. I have considered rival submissions and perused materials on record. As discussed earlier, the aforesaid disallowance was made in the original assessment order. Assessee contested the said disallowance before learned Commissioner (Appeals). Being satisfied with the submissions of the assessee, learned Commissioner (Appeals) deleted the disallowance. It is evident, the revenue had not filed any appeal contesting the aforesaid deletion before the Tribunal, whereas, the assessee filed an appeal before the Tribunal challenging couple of other disallowance. While deciding assessee's appeal, the Tribunal restored the issues to the assessing officer for de novo adjudication. Thus, as could be seen, the issue relating to delayed payment of employees provident fund attained finality after the decision of learned Commissioner (Appeals) in the first round itself. Surprisingly, while completing the assessment in pursuance to the order passed by the Tribunal, the assessing officer has again made the selfsame disallowance. This, in my view, is totally unjustified and amounts to travelling beyond the direction of the Tribunal while restoring the issues. Thus, the

impugned disallowance made by the assessing officer cannot be sustained. Accordingly, I delete the disallowance of Rs.6,69,035/-.

21. In the result, appeal is partly allowed.

Order pronounced on 30/08/2021.

Sd/-

(SAKTIJIT DEY)
JUDICIAL MEMBER

Mumbai, Dt : 30/08/2021

Pavanan

Copy to :

1. Appellant
2. Respondent
3. The CIT concerned
4. The CIT(A)
5. The DR, ITAT, Mumbai
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Asstt. Registrar, ITAT, Mumbai