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By

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Dear Readers,

Greetings for the season!

In this edition, we bring you the second part of article on the much await judgment by Honourable Supreme Court in the matter of tax withholding obligations for payments for usage of software by residents to non-residents. Hope you have enjoyed reading our first part.

The next article is on issues and vires of time period mentioned under Section 16(4) of Central Goods and Services Tax Act which deals with an outer time limit on availing the credit.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Founder & Chairman

GST

ISSUES INVOLVED AND THE VIRES OF TIME LIMIT UNDER SECTION 16(4) FOR AVAILMENT OF CREDIT

Contributed by CA Sri Harsha & CA Manindar

Introduction:

Section 16(4) of the CT Act[1] provides for time limit for availment of Input Tax Credit ('ITC'). The said section requires availment of ITC based on invoices/debit notes pertaining to a financial year on or before the due date for filing return under section 39 for the month of September following the end of such financial year or before furnishing relevant annual return whichever is earlier. Vires of this sub-section (4) of section 16 of the CT Act is under challenge before various High Courts. Considering this, an attempt is made in this article to bring out the issues surrounding this sub-section.

Background of Legal Provisions:

One of the objectives of introducing GST in India is to avoid cascading effect of taxes by ensuring seamless flow of credit. This is clearly evident from the ***"Statement of Objects and Reasons"*** forming part of the ***Constitution (One Hundred Twenty Second Amendment) Bill, 2014*** as introduced in Lok Sabha which was later enacted as the ***Constitution(One Hundred First Amendment) Act, 2016.*** The relevant extracts are reproduced as under:

> *"The Constitution is proposed to be amended to introduce the goods and services tax for conferring concurrent taxing powers on the Union as well as the States including Union territory with Legislature to make laws for levying goods and services tax on every transaction of supply of goods or services or both.* ***The goods and services tax shall replace number of indirect taxes being levied by the Union and the State Governments and is intended to remove cascading effect of taxes and provide for a common national market for goods and services.*** *The proposed Central and State goods and services tax will be levied on all transactions involving supply of goods and services, except those which are kept out of the purview of the goods and services tax"*

Section 16(1) of the CT Act provides that ITC can be claimed on tax charged over supply of all goods or services that are used or intended to be used in the course or furtherance of business. The relevant extracts are reproduced as under:

> *"Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49,* ***be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person."***

Section 16(2) of the CT Act provides for the conditions to be satisfied for entitlement to the ITC. The relevant extracts are reproduced as under:

[1]Central Goods and Services Tax Act, 2017

Notwithstanding anything contained in this section, no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless,—

(a) he is in possession of a tax invoice or debit note issued by a supplier registered under this Act, or such other tax paying documents as may be prescribed;

(b) he has received the goods or services or both.

Explanation.-For the purposes of this clause, it shall be deemed that the registered person has received the goods or, as the case may be, services—

(i) where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered person, whether acting as an agent or otherwise, before or during movement of goods, either by way of transfer of documents of title to goods or otherwise;

(ii) where the services are provided by the supplier to any person on the direction of and on account of such registered person

(c) subject to the provisions of section 41 or section 43A, the tax charged in respect of such supply has been actually paid to the Government, either in cash or through utilisation of input tax credit admissible in respect of the said supply; and

(d) he has furnished the return under section 39:

Provided that where the goods against an invoice are received in lots or instalments, the registered person shall be entitled to take credit upon receipt of the last lot or instalment:

Provided further that where a recipient fails to pay to the supplier of goods or services or both, other than the supplies on which tax is payable on reverse charge basis, the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability, along with interest thereon, in such manner as may be prescribed:

Provided also that the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon.

Section 16(2) starts with a non-obstante clause 'notwithstanding anything contained in this section'. It provides that no registered person shall be not entitled to claim the input tax credit in respect of any supply of goods or services or both unless the conditions specified therein are satisfied. The conditions specified involve possession of invoice/debit note, receipt of goods or services, tax charged in respect of supply has been paid to Government and he has furnished the return section 39.

Further, section 16(2) comes with three provisos. The first proviso provides that in case where goods supplied against an invoice are received in lots or installments, the registered person shall be entitled to take ITC upon the receipt of the last lot or installment. Second proviso provides for reversal of ITC in case where the recipient of supply has not made payment to the supplier within 180 days from the date of invoice. Third proviso provides for re-availment of such reversed ITC if payment is made by the recipient to the supplier at any time after the expiry of 180 days.

Coming to condition under clause(c) of section 16(2) of the CT Act,it has been provided that the registered person intending to have availed the input tax credit should also ensure that tax charged in respect of supply has been paid to Government. This clause is subject to the provisions of section 41 and section 43A.

Section 41 provides for that every registered person shall be entitled to take the credit of eligible input tax, as self-assessed, in his return and such amount shall be credited on a provisional basis to his electronic credit ledger.

At the time of enactment of GST law, it was contemplated that every registered person would be obligated to file three returns viz. GSTR-1 for outward supplies, GSTR-2 for inward supplies and GSTR-3 being assessment return providing the details of outward tax liability, ITC available on inward supplies and the amount tax paid using ITC and cash etc. Vide section 42 and section 43, it was proposed to match the details of outward supplies declared by a supplier in GSTR-1 return with the details of inward supplies declared by a recipient in his GSTR-2 and deny the ITC claim of recipient in the immediate return periods to the extent related to mismatched supplies. Subsequently, when new return filing system was proposed through GST RET-01 with GST Anx-1 and GST Anx-2, similar section i.e. 43A was introduced.

Thus, the originally contemplated framework is that ITC shall be allowed on a provisional basis in self-assessed returns and then such provisionally allowed ITC shall be considered as final when details of inward supplies match with the corresponding details of outward supplies declared by the supplier. Since, the initially prescribed return filing system by way of GSTR-2 and GSTR-3 or the subsequent new return filing system viz. GST RET-01 with GST Anx-1 and GST Anx-2 are never in operation and the fact that GSTR-3B is summary return, recipient of supply do not have any control over the supplier and therefore, it is practically impossible to comply with this condition.

Further compliance by supplier by way of filing the details of outward supplies in their GSTR-1 return and their reflected in GSTR-2A of vendor does not by itself give any assurance to recipient of supply that tax is paid by the vendor especially when the GSTR-3B return filing system lacks the facility of auto-population/auto-computation of outward tax liability based on outward supply details declared in corresponding tax period's GSTR-1 return. Considering this impossibility of compliance, the provision is also under challenge before various high courts[2] .

An amendment is proposed in section 16(2) through Finance Act, 2021 to insert sub-clause (aa) after sub-clause(a). The said sub-clause(aa) provides for additional requirement that the details of the invoice or debit note referred to in clause (a) has been furnished by the supplier in the statement of outward supplies and such details have been communicated to the recipient of such invoice or debit note in the manner specified under section 37.

[2]2021 (5) TMI 420 - Delhi High Court, 2021 (4) TMI 280 - Calcutta High Court, 2021 (3) TMI 1136 - AP High Court

This implies that this sub-clause(aa) makes it mandatory to avail ITC only when the supplier has declared the details of outward supplies in the statement of outward supplies (GSTR-1) and the same was communicated to recipient through GSTR-2A or GSTR-2B statement. This clause is not yet effective and is going to be effective from a date to be notified. Upon making effect of this clause, no recipient is entitled to take input tax credit without declaration of the details of outward supplies by supplier in GSTR-1. In other words, declaration of details of supply by supplier in his GSTR-1 return would become pre-requisite for recipient to avail input tax credit.

Further, it is also noteworthy to consider that unlike clause (c), clause (aa) is not subject to the provisions of section 41 or section 43A which means that in order to avail input tax credit even on provisional basis, recipient has to ensure that the details of outward supply are declared by the supplier in GSTR-1 return. After notification of this clause, ITC can be taken only when the details are available in GSTR-2A and GSTR-2B return.

In view of the above discussion on sub-section (1) and sub-section (2) of section 16 of the CT Act, a registered person is entitled to avail ITC of tax paid on all inward supply of goods or services that are used in the course or furtherance of business. Such ITC can be claimed when the conditions specified in sub-section (2) are satisfied. Credit can be claimed on provisional basis even if the condition specified under sub-section (2)(c) i.e. payment of tax by supplier on supply of the said goods or services is not satisfied. However, as the matching methods specified under section 42, section 43 and section 43A have not been implemented, the recipient has no control over payment of tax by supplier. Therefore, the requirement to fulfill this condition is challenged before various High Courts. In view of the lack of control over supplier and the fact that law permits provisional availment of ITC even if the condition specified under clause (c) was not satisfied, ITC gets accrued[3] to recipient of supply if all other conditions of section 16 (1) and section 16(2) are satisfied.

Sub-section (3) provides for a condition that no depreciation can be claimed under Income Tax Act, 1961 if the recipient is claiming ITC. The saidsub-section is not relevant in the present context and thereby not emphasized.

Coming to sub-section (4) of section 16, the same provides for time limit for availment of input tax credit. The said sub-section provides that input tax credit can be claimed on or before the due date for filing return under section 39 for the month of September following the end of the financial year to which the invoice or debit note pertains to or filing of relevant annual return whichever is earlier. The relevant extracts are reproduced as under:

A registered person shall not be entitled to take input tax credit in respect of any invoice or debit note for supply of goods or services or both after the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or debit note pertains or furnishing of the relevant annual return, whichever is earlier.

[3]Though GST is introduced with objective to avoid cascading effect of taxes and seamless flow of ITC, assuming ITC under GST law is also a mere concession like that of CENVAT and is not a right, if the conditions related to availment of ITC as specified in GST law are satisfied, such concession shall be considered as vested right. This is based on the principles laid down by Supreme Court in various judgments. Eicher Motors Ltd vs. UOI, 1999(106ELT3(SC) and CCE vs. Dal Ichi Kakaria Ltd, 1999(112) ELT 353 (SC) are cited for ready reference.

Considering the above extracts of section 16(4), the time limit involved in availing ITC can be understood as under:

Financial Year	Invoice pertaining to	Due date of Filing GSTR3B for September of following FY	Date of Actual Filing of Annual return	Date on or before which the credit should be taken in order to be eligible
2019-20	April 2019	20.10.2020	31.12.2020	20.10.2020
2019-20	April 2019	20.10.2020	30.09.2020	30.09.2020
Note: Due dates mentioned above are not actual dates and taken for only for purposes of simulation.				

Challenge on the vires of Section 16(4):

As mentioned supra, the vires of section 16(4) which provide for time limit for availment of ITC is under challenge in several matters before various High Courts. All these matters are at hearing stage and are pending for disposal. The grounds submitted by writ applicants as made available in public domains[4] are broadly summarized as under:

Sl. No	Name of the Matter and Grounds of Challenge
1	**In the matter of Bagmane Developers vs. Union of India**[5] • Petitioners in this case not availed credit related to construction of commercial space intended for renting for the period between July 2017 to April 2019. In view of the decision of Orissa High Court in the case of Safari Retreats Private Limited v. Chief Commissioner of CGST[6], petitioner claimed entire ITC related to the above period in GSTR-3B return of May 2019. The said claim was proposed to be recovered by department by serving show cause notice.In this context, the vires of section 17(5)(c) & (d) and section 16(4) were challenged. • ***An assessee has a vested and an accrued right to avail input tax credit once the conditions as contemplated under Section 16[1] of the CT Act are satisfied with a simultaneous right to claim adjustment of tax on outward supply of goods and services.*** This right would be an indefeasible right and therefore such right cannot be taken away in any manner that is impermissible in law. ***This substantiative right cannot be abridged by law of limitation. The law of limitation can only bar a remedy and cannot negate an accrued or a vested right.*** • The provisions of Section 16[4] of the CGST Act in imposing a negation of the accrued and vested rightsviolate this seminal proposition and as such, Section 16 [4] of the GST Act is in violation of Article 300A[7] of the Constitution of India.

[4]Section 16(4) was also challenged before Gujarat High Court in the case of M/s Niyati Construction vs Union of India (Special Civil Application No. 5268 of 2020), before the Madhya Pradesh High Court in the case of M/s Shreeji Earth Movers vs UOI (WP No.05434/2020). As grounds of challenge are not available in public domain, the same are not considered for the table indicating grounds of challenge.

[5]TS-918-HC-2020(KAR)-NT

[6]TS-350-HC-2019(ORI)-NT

[7]Article 300A provides that no person shall be deprived of his property save by authority of law.

2	**In the matter of Rainbow Infrastructure Pvt. Ltd. & Anr. vs. Assistant Commissioner, SGST**[8] • Limitation provided under section 16(4) is merely procedural in nature and cannot override substantive conditions as mandated under section 16(1) and section 16(2) of the Act. • If the restriction under Section 16(4) of the Act is invoked and ITC is denied then the non-obstante clause in Section 16(2) of the Act would cease to have any meaning or purpose andwould be rendered otiose. • ***ITC is not taken through return but instead it is taken through books of account immediately on receipt of goods or services.*** • The provisions of section 16(4) are violative of Article 14[9] , Article 19(1)(g)[10] and Article 300A of the Constitution. • Denial of ITC would defeat the object of 122nd Constitutional Amendment Bill, 2017 which is intended to avoid cascading effect of taxes.
3	**In the matter of M/s Surat Mercantile Association & Others vs UOI & 2 Others**[11] • The taxpayers cannot be made to suffer by not allowing the ITC on account of the failure on the part of the respondents to notify the Forms GSTR - 2 and GSTR - 3 respectively. ***Retrospective amendment in Rule 61 of the CT Rules to notify GSTR-3B return as return under section 39 is unconstitutional and being violative of Article 14, Article 279A***[12] ***of the Constitution.*** • It is also pleaded before the court that appropriate directions may be issued declaring that Section 39 of the Act does not bar filing of the returns without payment of tax and the GSTN portal not allowing furnishing of such returns without payment of tax be declared as arbitrary and unreasonable being violative of Article 14 of the Constitution of India.
4	**In the matters of M/s Subh Interiors vs. UOI**[13] **& Shri Kumaran construction Co vs. UOI**[14] • Section 16(4) is violative of Article 14, Article 19(1)(g) and Article 300A of the Constitution.

[8]TS-997-HC-2020(CAL)-NT
[9]Article 14-Equality before law
[10]Article 19(1)(g)— Right to practice any profession, or to carry on any occupation, trade or business
[11]2021 (1) TMI 1096- Gujarat High Court
[12]Article 279A— clause(6) of this Article provides that the GST Council while discharging functions, it should be guided by the need for harmonized structure of goods and services tax and for the development of a harmonized national market for goods and services.
[13]2020 (12) TMI 833-Gujarat High Court
[14]2020 (11) TMI 182-Jharkhand High Court

Key Issues for Consideration of Judiciary:

Considering the above grounds for challenging the vires of section 16(4) in the above referred matters, the following key issues require the attention of the Judiciary.

Issue #1 - Section 16(1) and Section 16(2) create a vested right and the same cannot be extinguished by time limit under section 16(4):

As discussed supra, section 16(1) provides that a registered person is entitled to avail input tax credit on all goods or services procured in the course or furtherance of business or commerce. Section 16(2) provides for various conditions to be satisfied in order to avail the input tax credit. These conditions do not include time limit as it is provided under a separate sub-section (4). In view of this reason, it is argued in these matters that section 16(1) and section 16(2) by themselves create a vested right. The time limit provided under section 16(4) is procedural in nature and cannot extinguish the accrued ITC being a vested right.

Under the erstwhile CENVAT Credit Rules,2004 the condition related to availment of CENVAT Credit was provided under Rule 4. Time limit to avail CENVAT Credit was provided under these Rules. The condition related to time limit was provided under the conditions mentioned for eligibility to CENVAT Credit.

However, under the GST regime, conditions related to eligibility of ITC are provided under section 16(1) and section 16(2) respectively. Time limit for claim of ITC has not been included in these conditions and the same is provided through separate sub-section (4). Therefore, an attempt is made to argue that provisions of section 16(1) and section 16(2) create a vested right and such right cannot be taken away by limitation provided under section 16(4). Thereby the time limit provided under sub-section (4) is procedural in nature and is not mandatory.

Question would arise whether imposition of condition of the nature of time limit within which the credit accrued should be availed amounts to taking of vested right. Supreme Court in the case of Osram Surya Private Limited vs. CCE[15] in the context of erstwhile Rule 57G of Central Excise Rules, 1944 which had provided for time limit of six months for availment of CENVAT Credit, held that the amendment imposing time limit condition does not take away any vested right but merely introduces limitation for availment of credit. Considering this, let's see how the court will interpret the provisions of section 16(1), 16(2) and section 16(4) on the lines of substantive vested right vis-a-vis the time limit for claim of right.

Issue#2 - Retrospective Amendment to Rule 61 will not legally withstand as it is taking away the vested right:

Section 16(4) of the CT Act provides the ITC should be claimed on or before the due date for filing return under section 39 for the month of September following the end of financial year or filing of relevant annual return whichever is earlier. As filing of annual return got excessively extended for FY 2017-18, FY 2018-19 and FY 2019-20 due to various reasons, for these financial years, the due date for filing the return under section 39 for the month of September became relevant.

[15] 2002 (142) E.L.T. 5 (S.C.)

As discussed supra, initially when the GST law is introduced, three types of returns are contemplated viz. GSTR-1, GSTR-2 and GSTR-3. However, GSTR-2 and GSTR-3 were not implemented and were taken away. Under Rule 61 of the CT Rules, GSTR-3 return was notified as return under section 39. The relevant extracts under sub-rule (1) are reproduced as under:

Every registered person other than a person referred to in section 14 of the Integrated Goods and Services Tax Act, 2017 or an Input Service Distributor or a non-resident taxable person or a person paying tax under section 10 or section 51 or, as the case maybe, under section 52 shall furnish a return specified under sub-section (1) of section 39 in FORM GSTR-3 electronically through the common portal either directly or through a Facilitation Centre notified by the Commissioner.

Sub-section (5) of the said rule provided that in cases where due dates for filing GSTR-1, GSTR-2 and GSTR-3 are extended, then taxpayer is required to furnish return under GSTR-3B. Considering this rule position, the trade and industry were under the impression that GSTR-3 was the return under section 39 and since the same was not facilitated in GST portal much after the end of FY 2017-18 and FY 2018-19, the time limit condition under section 16(4) was under dormant.

Much to the surprise of everyone a press release dated 18.10.2018, it is clarified that GSTR-3B return was the return under section 39 and the last date to avail ITC for the period July 2017 to March 2018 was the last date for filing September 2018 return i.e. 20th October 2018. The relevant extracts are reproduced as under:

It is clarified that the furnishing of outward details in FORM GSTR-1 by the corresponding supplier(s) and the facility to view the same in FORM GSTR-2A by the recipient is in the nature of taxpayer facilitation and does not impact the ability of the taxpayer to avail ITC on self-assessment basis in consonance with the provisions of section 16 of the Act. The apprehension that ITC can be availed only on the basis of reconciliation between FORM GSTR-2A and FORM GSTR-3B conducted before the due date for filing of return in FORM GSTR-3B for the month of September, 2018 is unfounded as the same exercise can be done thereafter also.

Aggrieved by this clarification, the same was challenged before theHon'ble Gujarat High Court in the case of AAP and Co., Chartered Accountants vs Union of India, dated 24.06.2019[16] wherein it was held that FORM GSTR-3B is not a 'Return' under section 39 and Form GSTR-3 is the 'Return' under section 39. The Court also held that the return in form GSTR-3B is only a temporary stop gap arrangement till the due date of filing the return in Form GSTR-3 is notified. The Court made the following observations in paras 31 to 33 of the Judgement-

> *31. It would also be apposite to point out that the Notification No.10/2017 Central Tax dated 28th June 2017 which introduced mandatory filing of the return in Form GSTR-3B stated that it is a return in lieu of Form GSTR-3. However, the Government, on realising its mistake that the return in Form GSTR-3B is not intended to be in lieu of Form GSTR-3, rectified its mistake retrospectively vide Notification No.17/2017 Central Tax dated 27th July 2017 and omitted the reference to return in Form GSTR-3B being return in lieu of Form GSTR-3.*

[16] 2019 (7) TMI 401 - Gujarat High Court

32. Thus, in view of the above, the impugned press release dated 18th October 2018 could be said to be illegal to the extent that its para-3 purports to clarify that the last date for availing input tax credit relating to the invoices issued during the period from July 2017 to March 2018 is the last date for the filing of return in Form GSTR-3B.

33. The said clarification could be said to be contrary to Section 16(4) of the CGST Act/GGST Act read with Section 39(1) of the CGST Act/GGST Act read with Rule 61 of the CGST Rules/GGST Rules.

(Emphasis Supplied)

Subsequent to this decision, Notification No. 49/2019-CT(R) dated 09.10.2019 was notified by Government through which a proviso is introduced in sub-rule 5 of Rule 61 to provide that where a return in FORM GSTR-3B is required to be furnished by a person referred to in sub-rule (1) then such person shall not be required to furnish the return in FORM GSTR-3. This proviso is inserted retrospectively with effect from 01.07.2017 onwards in order to provide that GSTR-3B is the return under section 39.

The impact of this proviso was that the time limit provided under 16(4) to avail ITC which was originally contemplated to expire from the due date for filing GSTR-3 for September following the end of financial year has been altered to the due date for filing GSTR-3B return. The said time limit was altered retrospectively from 01.07.2017 onwards in order to nullify the impact of the Gujarat High Court decision in AAP and Co (supra).

In view of the above legal developments, with respect to ITC belonging to FY 2017-18 and FY 2018-19, the trade was of the understanding that return under section 39 is GSTR-3 return. As the said return was not notified and subsequently through retrospective amendment, GSTR-3B was notified as return under section 39, the amendment was brought in by delegated legislation to retrospectively take away the vested right. It is in view of this reason, the validity of retrospective applicability of this rule is under challenge in the matter of M/s Surat Mercantile Association (supra).

Considering these developments, it is worth to examine similar position under the erstwhile CENVAT Credit Rules, 2004. Time limit provisions to avail credit within six months from the date of invoice are introduced in Rule 4 of the CENVAT Credit Rules, 2004 with effect from 11.07.2014. Issue arose whether such six months' time limit was applicable to invoices that were dated prior to 11.07.2014. This issue was examined in the following cases and all of them have taken a unanimous view that the amendment introducing time limit cannot be made applicable retrospectively to invoices dated prior to 11.07.2014. In the case of Global Ceramics Private Limited vs. Principal Commissioner of Central Excise[17] , it was held as under:

15. In the present case, we are concerned with the amendment to the Rule 4 of the CCRs with effect from 11thJuly, 2014, which reads thus :

"Provided also that the manufacturer or the provider of output services shall not take Cenvat credit after 6 months of the date of issue of any of the documents in sub rule (1) of rule 9."

[17]2019 (26) G.S.T.L. 470 (Del.)

16. It is in terms of this amendment that it was provided that the Cenvat Credit must be taken within one year of the issue of invoice for input goods or input services.

17. There is substance in the contention of the Learned Counsel for the Assesses in both the cases that the above amended provision cannot be given retrospective effect. As explained in Eicher Motors Ltd. v. Union of India (supra) the rule of lapse of credit lying with it unutilized on the date of amendment, cannot be applied to the goods manufactured prior to the date of the amendment. This is based on the principle that the right to adjustment of tax on final products accrues to an Assessee on the date when they paid the tax on the raw materials and that right would continue until the facility available thereto gets worked out. In fact, the judgment in Osram Surya (P) Ltd. v. Commissioner of Central Excise, Indore (supra) approvingly refers to the judgment in Eicher Motors Ltd. v. Union of India (supra).

22. Consequently, in the present case, the Court is satisfied that the Amendment to Rule 4(1) CCRs prescribing a time limit for claiming Cenvat Credit will not apply to the consignments in the present case where the import took place prior to the date of the amendment and the deemed manufacture took place when the MRP was altered, which also happened prior to the amendment. In other words, the CVD paid by the BRCPL will have to be permitted to be adjusted against the CE duty settled as will the service tax paid on the input services.

The other judgments on this issue can be referred to Bharat Aluminum Company Limited vs. Joint Commissioner Central Tax, [2019 (7) TMI 1084- CESTAT Delhi], Hindustan Coca Cola Beverages Pvt. Ltd. vs. Commissioner of Central Tax [2018 (10) TMI 1366-CESTAT Bangalore], Industrial Filters & Fabrics Pvt. Ltd. vs. CGST & CE, Indore[2019 (1) TMI 1426-CESTAT New Delhi], Suryadev Alloys and Power Pvt Ltd. vs. Commissioner of GST & Central Excise, Chennai [2018 (11) TMI 1019-CESTAT Chennai]Umesh Engineering Works vs. Commissioner of Central Tax, Bengaluru West [2019 (1) TMI 1158-CESTAT Bangalore] and Sarda Energy and Minerals Ltd. vs. CCE & ST, Raipur [2019 (4) TMI 473-CESTAT New Delhi].

Considering the above proposition laid down with respect to time limit applicability for claim of CENVAT Credit, it can be argued that amendment made to Rule 61 is retrospectively taking away the right of credit accrued under section 16(1) and section 16(2) and the same is not tenable in law. Considering the above, there is a strong case on this point. Taxpayers who have availed ITC pertaining to FY 2017-18 and FY 2018-19 belatedly after the time limit specified in section 16(4) can pin their hopes on this argument.Let us see what the courts say on this.

Issue #3 - Whether time limit under section 16(4) render the non-obstante clause in section 16(2) as otiose:

Another argument proposed in the matter of Rainbow Infrastructure Pvt. Ltd. & Anr. vs. Assistant Commissioner (supra) is that section 16(2) starts with a 'Non-obstante clause' with the phrase *'Notwithstanding anything contained in this section'.* In view of this overriding effect, the credit accrued upon satisfaction of the conditions specified under section 16(2) cannot be taken away by limitation provided under section 16(4). Thereby the time limit specified under section 16(4) is procedural and its compliance is not mandatory to avail ITC.

In the humble opinion of paper writers, use of the phrase 'Notwithstanding anything contained in this section' under the provisions of section 16(2) would override all other sub-sections of section 16, require critical examination by courts. It is true that non-obstante clause will override the other provisions to the extent they are in direct conflict. It is equally well established principle[18] that while dealing with non-obstante clause, court must try to find out the extent to which the legislature had intended to give one provision overriding effect over another provision.

Considering this, mere presence of non-obstante clause in section 16(2) will not automatically override the specific provisions of section 16(4). The courts have to gather the legislative intent of the use of the non-obstante clause in section 16(2) and decide whether it has overriding effect over section 16(4). This issue has a direct bearing to the issue whether time limit provided under section 16(4) for availment of ITC is mandatory or procedural in nature.

Issue # 4 - Whether availment of ITC in books of account is sufficient compliance to time limit under section 16(4):

Another important aspect which requires examination by courts is whether claim of ITC by recording in books of account within the time limit provided under section 16(4) is sufficient compliance even though the said claim was declared in GSTR-3B returns filed after time limit specified in the said section 16(4). On plain reading of Section 16(4), there is no mention on how the ITC shall be taken.

Before we delve upon this issue, it is noteworthy to understand that under erstwhile CENVAT regime, there is no requirement that ITC is to be mentioned in statutory returns in order to avail input tax credit within the limitation provided for availment of input tax credit. In this regard, reference can be made to the following judgments Svizera Labs Private Limited vs. CCE, 2018 (363) ELT 1186 (Tri-Mumbai) and Bharat Petroleum Corporation Limited vs. CCE, 2019(365) ELT 536 (Tri-Mumbai).

In view of the above discussion, under the erstwhile CENVAT regime, it is sufficient compliance with the time limit condition if it is established that CENVAT Credit was availed in books of account/financial records within the time limit specified even though such credit was declared in statutory returns belatedly.

Coming to GST regime, section 16(4) does not specify the manner in which input tax credit can be availed. Section 41 of the CT Act provide that ITC as self-assessed in the return be credited to electronic credit ledger. Section 49(2) provides that the input tax credit as self-assessed in the return of a registered person shall be credited to his electronic credit ledger, in accordance with section 41 or section 43A, to be maintained in such manner as may be prescribed. Section 39(1) requires every taxpayer to furnish the details of input tax credit availed in the return notified under section 39.

Crediting of ITC to electronic credit ledger is referred to under section 41 and section 49(2). In both the cases, the language indicate that what is to be credited to electronic credit ledger is the ITC as self-assessed in the return. On the contrary, section 39(1) requires the taxpayer to furnish the details of ITC availed. The use of different phrases as highlighted above indicate that availment of input tax credit is

[18] In A.G. Varadarajulu v. State of Tamil Nadu [(1998) 4 SCC 231]

different from self-assessment in the return. Further, the condition provided in section 16(2)(d) requires the recipient of supply to file return under section 39. It does not expressly provide that the ITC involved should also be mentioned in the return filed under section 39. Further, section 35(1) requires every registered person to keep and maintain at his principal place of business a true and correct account of input tax credit availed.

All these indicate that availment of ITC is different from its assessment in return. It can be strongly argued that even under GST regime, condition related to availment of ITC within the time limit provided under section 16(4) is said to be satisfied if such ITC is availed by accounting in books of account/GST records within the stipulated time even though the said claim was indicated in the return belatedly.

Conclusion:

Basis the above discussion, it is clear that applicability of time limit provided under section 16(4) for availment of ITC is very contentious and the matter is pending before various High Courts. Various key issues arise in these litigations. These involve validity of retrospective amendment to Rule 61, whether time limit under section 16(4) is mandatory or procedural in nature, relevance of non-obstante clause in section 16(2), whether availment of ITC in books of account is sufficient compliance with section 16(4) or is it required to mention the claim amounts by filing statutory return notified under section 39. As filing of return under section 39 is linked to payment of taxes, many taxpayers could not file their returns in time due to liquidity issues and they could not report their ITC claim by filing returns in time. Availability of these credits depend upon the outcome of these issues raised before various High Courts. Let see what will be the court

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INCOME TAX

MUCH AWAITED JUDGMENT OF DECADE - ENGINEERING ANALYSIS CENTRE OF EXCELLENCE PRIVATE LIMITED - PART II

Contributed by CA Sri Harsha

This article is on one of the vexatious issues of taxation on the software payments made by residents to non-residents. The said issue was put to an end by the Honourable Supreme Court in the matter of Engineering Analysis Centre of Excellence Private Limited[1] (for brevity 'EAC') in favour of the tax payer. Let us proceed to understand the core issues, the history involved surrounding the issue, the arguments by and against tax payer, the analysis by Supreme Court and conclusions therein.

Modus Operandi:

This is Part II of the two part series of the article. In the first part, we have dealt with framing of issue, history and arguments made by tax payer and tax authorities. In this part, we shall deal with analysis of Honourable Supreme Court along with the conclusion. We request the reader to read both the parts to drive home the point. Now, let us proceed with Part II.

Analysis by Supreme Court:

The Supreme Court after setting out the provisions of ITA and Copyright Act has brushed away the argument of Revenue which canvassed the view that the payer has to withhold tax at source even such income is not chargeable to tax in India. The Court stated that Section 195 is clear to state that the obligation of withholding would trigger only if such income was chargeable to tax in India, which is again determined by applying the provisions of Section 5 read with Section 9. The Court reiterated that the above position is made abundantly clear in the matter of GE Technology Centre Private Limited (supra). The Court also brushed the reliance of Revenue in the matter of PILCOM (supra) stating that, the said judgment was in the context of Section 194E and not under Section 195. The Court stated that the provisions of Section 194E does not have any reference to chargeability of income under the provisions of ITA, which do find a place in Section 195. Hence, the decision in PILCOM which was dealing on obligation of withholding of tax for payments made under Section 194E, which do not have reference to any chargeable to tax in India cannot be applied to situation under Section 195.

The Court stated that though the phrase 'copyright' has not been defined in the Copyright Act separately, the provisions of Section 14 of the said act makes it clear that 'copyright' to mean the 'exclusive right' subject to provisions of the act, to do or authorise the doing of certain acts 'in respect of a work'. Thus, when an author in relation to 'literary work' which includes a 'computer programme', creates such work, such author has an exclusive right, subject to the provision of the Act, to do or authorise the doing of several acts in respect of such work. When the owner of copyright in a literary work assigns wholly or in part, all of any rights contained in Section 14(a) and (b), in the said work for a consideration, the assignee of such right becomes entitled to all such rights comprised in the copyright that is assigned, and shall be treated as owner of copyright of what is assigned to him. Further, the owner of copyright in any literary work may grant any interest in any right mentioned in Section 14(a) by license in writing by him to the licensee, under which, for parting with such interest, royalty becomes payable. When such license is

[1] [2021] 432 ITR 471 (SC)

granted, copyright is infringed when any use, relatable to the said right/interest that is licensed, is contrary to the conditions of the license so granted. Hence, if the right parted by the original owner/author is to allow another person to reproduce and commercially exploit the intellectual property involved, then the person would not be said to be infringing the copyright since he has not violated any conditions of the license. Accordingly, the Court brushed away the plea of Revenue, wherein it was asserted that making copies of copyright and using them would mean infringement of copyright.

Reproduction vs Usage:

The Court then referring to the conditions in various contracts has stated that what is granted to the distributors is only a non-exclusive, non-transferable license to resell computer software and it is expressly stated that no copyright in the computer programme is transferred either to the distributor or to the end-user. The Court stated that the distributor retains only part of the consideration as profit and the retention is also for the reason that the distributor is a reseller but not because he has obtained a right to use the product. Further, the end-user who is directly sold the computer programme, can use only it by installing it in the computer hardware owned by the end-user and cannot in any manner reproduce the same for sale or transfer, contrary to the term of EULA. The Court stated that none of the facts involved in the current appeals involves grant of license in terms of Section 30 of Copyright Act, which transfers an interest in all or any of the rights contained in Section 14(a) and 14(b). The Court stated that only such grant of licenses which fall under the category of Section 30 can be said to be grant of copyright in order to characterise the income arising thereof as a royalty. Since all the EULAs impose restrictions or conditions for use of computer software, it cannot be said what was granted was a license in terms of Section 30. The Court took an example to elucidate the said point. If an English publisher sells 2000 copies of a particular book to an Indian distributor, who then resells the same at a profit, no copyright in the aforesaid book is transferred to the Indian distributor, either by way of license or otherwise, in as much as the Indian distributor only makes a profit on the sale of each book. Importantly, there is no right in the Indian distributor to reproduce the aforesaid book and then sell the copies of the same. On the other hand, if an English publisher were to sell the same book to an Indian publisher, this time with the right to reproduce and make copies of the aforesaid book with permission of the author, it can be said that copyright in the book has been transferred by way of license or otherwise, and what the Indian publisher will pay for, is for the right to reproduce the book, which can then be characterised as royalty for the exclusive right to reproduce the book in the territory mentioned by the license.

The Court then proceeded to make a reference to the judgment of State Bank of India[2] which was under the Customs Act, 1962 (for brevity 'Custom Laws'). The issue involved therein is State Bank of India has imported a consignment of computer software and manual from Kindle Software Limited, Ireland and cleared the goods for home consumption on payment of customs duty. State Bank of India has filed a refund application stating that interpretative note relating to Rule 9(1)(c) of Customs Valuation (Determination of Price of Imported Goods) Rules, 1998 suggests that royalties and licenses paid for right to reproduce the imported goods should not be added to the price actually paid or payable. State Bank of India has taken a plea that since the software imported involves right to reproduce, the royalties paid should not be added to the assessable value of the goods. Since the same were already included, State Bank of India has applied for refund. The Court in the said matter made an important observation vide Para 21. It stated that reproduction and use are two different things. Since in the facts of State Bank of

[2] [2001] 1 SCC 727

India, what was permitted by Kindle Software Limited is use but not the right to reproduce. The Court stated that what was paid by State Bank of India was for the license and not the right to reproduce and accordingly State Bank of India would not be eligible for refund. Taking clue from the above judgment, the Supreme Court in the matter of EAC stated that the right to reproduce would entail parting of copyright and whereas right to use does not entail any copyright.

The Court also referring to the real nature of transactions involved stated that what is licensed by foreign, non-resident supplier to the distributor and resold to the resident end-user, or directly supplied to end-user, is in fact the sale of a physical object which contains an embedded computer programme and therefore, essentially a sale of goods as held by the Supreme Court in the matter of Tata Consultancy Servies (supra).

The Supreme Court then proceeded to analyse the definition of 'royalty' in the context of DTAA and ITA. The Court analysed that the definition under Article 12(3) of Indo-Singapore DTAA which deals with 'royalty' is exhaustive and differs with the definition under the local law at least in three aspects. The main aspect under the provision of ITA is the presence of Explanation 2(v) to Section 9(1)(vi). Vide such part of the explanation, 'the transfer of all or any rights (including the granting of license) in respect of copyright, literary, artistic or scientific work including..' is covered under the definition of 'royalty'. Harping on this, the Revenue contested that the consideration received by foreign supplier for granting of license comes under the ambit of 'royalty' because it specifically gets mentioned in Explanation 2(v).

However, the Supreme Court rejected the above contention by stating that a payment to fall under the ambit of Explanation 2(v) should in the first place involve transfer of all or any rights. The rights that are being discussed are the rights that were mentioned in Section 14(a), Section 14(b) and Section 30 of Copyright Act. Hence, unless the rights which are mentioned in Section 14(a) and Section 14(b) are transferred either in full or any, there is nothing which falls under the ambit of Explanation 2(v). The phrase 'including the granting of license' has also to be read to mean that the grant of license includes the parting of rights as mentioned in Section 14(a) and Section 14(b). Since in all the matters, the facts involved the granting of license which is not in the nature of Section 14(a) and Section 14(b), such consideration arising for grant shall not fall under the ambit of Explanation 2(v) to Section 9(1)(vi).

Conclusions by Supreme Court:

The Supreme Court then proceeded to analyse the various judgments issued by Authority for Advance Ruling (for brevity 'AAR'), Tribunals and High Courts. The discussion can be summarised as under:

S.No.	Authority	Matter	Analysis
1	AAR	Dassault Systems KK[3] (India – Japan DTAA) ***(Approved by SC)***	• Dassault Systems UK, a company incorporated in Japan, which marketed licensed computer software products, through a distribution channel comprising value added resellers (VAR), who were independent third party resellers in the business of selling software to end-users. • The question before AAR was that whether the amounts arising from sale of software products to independent third party resellers will be taxable as business profits under Article 7 and will not constitute royalties and fee for technical services as defined in Article 12? • The AAR before proceeding to answer the above question made reference to classic treatise of Copinger and Skon James on Copyright. • The AAR has extracted a passage from the above classic treatise wherein it was stated as ***'It is important to recognize that ownership of copyright in a work is different from the ownership of the physical material in which the copyright work may happen to be embodied. Just as the owner of the physical material on which a copyright work is first recorded is not necessarily the first owner of the copyright, so the transfer of title to the original physical material does not by itself operate to transfer the title to the copyright. Thus, to take an obvious example, the purchaser of a book or video recording becomes the owner of the physical article but he does not thereby become the owner of any part of the copyright in the works reproduced in it. The copyright in the literary work remains with the copyright owner, who enjoys and is entitled to enforce all the exclusive rights of copying, publication, adaptation, sale, rental and so on conferred on him by copyright law. The purchaser does not acquire by his purchase any right, either by way of assignment or license, to exercise any of those exclusive rights'.***

[3] [2010] 322 ITR 125 (AAR)

			• Another important passage which was referred by AAR, wherein it was stated that '***A mere licence from the copyright owner confers no proprietary interest on the licensee enabling him, for example, to bring proceedings in his own name, unless coupled with the grant of some other interest, for example, the right to take property away. Statute apart, even an exclusive licence, which is merely the leave to do a thing coupled with a promise not to do, or give anyone else permission to do that thing, gives the licensee no right to sue in his own name for infringement nor any other proprietary interest. In copyright law this general rule is altered by statute in the case of exclusive licences which comply with prescribed formalities. The 1988 Act confers on such a licensee a procedural status which enables him to bring proceedings but otherwise the rule is unchanged: an exclusive licensee has no proprietary interest in the copyright'.*** • The AAR after setting out the terms in EULA has stated that end-user is not given the authority to do any of the acts contemplated in Section 14(a) not to speak of exclusive right. Further, the entire tenor of the agreement and various stipulations contained therein make it clear that no rights in derogation of the Dassault System's exclusive right in relation to the copyright have been conferred to end-user or VAR. The core of the transaction in the words of AAR is that to authorise the end-user to have access to and make use of licensed software products over which the Dassault System's have exclusive copyright, without giving any scope for dealing with them any further. • The AAR further stated that passing on a right to use and facilitating the use of a product for which the owner has a copyright is not the same thing as transferring or assigning rights in relation to copyrights. **The enjoyment of some or all the rights which the copyright owner has, is necessary to trigger the royalty definition**. Accordingly, an agreement with a non-exclusive and non-transferable license enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in copyright. • The AAR made an important observation with respect to the phrase 'including the granting of license' found in Explanation 2(v)

2	AAR	Geoquest Systems B V Gevers Deynootweg[4] (India – Netherlands DTAA) ***(Approved by SC)***	• The Applicant sold certain software packages to the Oil and Natural Gas Corporation in India. The applicant has approached AAR to determine whether the said amounts paid by Oil and Natural Gas Corporation would constitute royalty. • The AAR following the decision in their earlier matter of Dassault Systems KK has held that the amounts paid by the buyer are not in the nature of royalties
3	AAR	Citrix Systems Asia Pacific Ptyl. Ltd[5] (India – Australia DTAA) ***(Rejected by SC)***	• The AAR once again was confronted with a similar question as in the case of two above. The Australian company had entered into a distribution agreement with an independent Indian company engaged in business of distribution of computer software and hardware. • The AAR after setting out the various provisions of ITA and Indo-Australian DTAA has arrived at a diametrically opposite conclusions to that of Dassault (supra) and Geoquest (supra). The AAR has stated that when a software is created by a person who acquires a copyright for it, he becomes the owner of that copyright. He can transfer or license that right either by himself or through an agent. When he sells or licenses for software for use, he is also selling or licensing the right to use the copyright embedded therein. The AAR stated that whenever a software is assigned or licensed for use, there is involved an assignment of the right to use the embedded copyright in the software or a license to use the embedded copyright, the intellectual property right in the software. Therefore, it concluded that it is not possible to divorce the software from the intellectual property right of the creator of the software embedded therein and accordingly the payment would be called as royalty. • The AAR has distinguished the decision in the matter of Dassault (supra) by stating that the facts involved in said matter was that the end-user has no rights in the license except using the same. The AAR however have not stated that the fact pattern in the subject matter are different. **Observations by Supreme Court:** • The Supreme Court rejected the above observations of AAR. The Supreme Court stated that what an end-user would obtain is a copy of license and cannot be stated that, what is also licensed is the right to use the copyright embedded therein. The Court stated that EULA would never involve transfer of rights as envisaged under Section 30 or Section 14 of Copyright Act.

[4] [2010] 327 ITR 1 (AAR)
[5] [2012] 343 ITR 1 (AAR)

4	HC [KA]	Samsung Electronics Co. Limited[6] (India –USA) (India – France) (India – Sweden) ***(Rejected by SC)***	• The Karnataka High Court has also stated that what was sold/licensed by way of computer software, included the grant of a right or interest in copyright, and thus gave rise to the payment of royalty. The Court stated that the right to make a copy of the software and use it for internal business by making the copy of the same and storing the same in the hard disk of the designated computer and taking back up would itself amount to copyright work under Section 14 of Copyright. • The Court therefore hold that amount paid towards supply of shrink-wrapped software or off-the-shelf software is not the price of CD alone nor software alone nor the price of license granted. The court stated that this is a combination of all and in substance, unless license is granted permitting the end user to copy, and download the software, the dumb CD containing software would not in any way be helpful to the end user as software would become operative, only if it is downloaded to the hardware of the designated computer as per the terms and conditions of the agreement and that makes the difference between the computer software and copyright, in respect of books orpre-recorded music [CD], as book and pre-recorded music CD can be used once they arepurchased, but so far as software stored in dumb CD is concerned, the transfer of dumb CD byitself would not confer any, right, upon the end user and the purpose of the CD is only to enablethe end user to take a copy of the software and to store it in the hard disk of the designatedcomputer if licence is granted in that behalf and in the absence of licence, the same would amountto infringement of copyright, which is exclusively owned by non-resident suppliers, who wouldcontinue to be the proprietor of copyright. • Therefore the Court has held that there is no similarity between the transaction of purchase of book or CD containing software and in view the same, the legislature in its wisdom, has treated the literary work like books and other articles separately from 'computer software' within the meaning of copyright as referred under Section 14 of Copyright Act. **Observations by Supreme Court:** • The Supreme Court has stated that the Karnataka High Court has erred in the same way as the AAR erred in Citrix Systems (supra). The Supreme Court stated that the failure to make a distinction between computer software that was sold/licensed on a CD/other physical medium and the parting of the copyright in respect of any of the rights or interest in any of the rights mentioned in Section 14(a) and Section 14(b) of the Copyright Act.

[6] [2012] 345 ITR 494

5	HC [KA]	Synopsis International Old Limited[7] (India – Ireland DTAA) **(Rejected by SC)**	• In this matter, the Karnataka High Court placing extensive importance on the phrase 'in respect of' appearing in Explanation 2(v) to Section 9(1)(vi) has held that without transferring a right in the copyright it is possible to receive consideration for the use of intellectual property for which the owner possess copyright. Ultimately, the consideration paid for the usefulness of the material object in respect of which there exists a copyright. Therefore, the court held that the intention was not to exclude the consideration paid for the use of such material object which is popularly known as copyrighted article. The court held that even in respect of a copyrighted article the same is transferred, no doubt the right in the copyright is not transferred, but a right **in respect of a copyright contained in the article is transferred and accordingly the said payment would fall under the ambit of royalty.** • The Court also made an observation that the meaning of 'copyright' as laid down in Copyright cannot be imported into the ITA. The Court held that the Explanation 2 to Section 9(1)(vi) made it clear that royalty would mean consideration for transfer of all or any rights including the granting of license and therefore, the word exclusive right used in Section 14 do not fit in the meaning of royalty as per Explanation 2. The Court's reasoning is that since the ITA lays down a specific meaning for 'royalty', the consideration has to be decided in terms of such meaning and not under the meaning as per Copyright Act. Accordingly, the Court held that payments made for acquisition of partial rights in the copyright without the transfer fully alienating the copyrights will represent royalty where the consideration is for granting of rights to use the programme in the manner that would, without such license, constitute an infringement of copyright. The Court further held that the definition of 'royalty' as per DTAA would mean payment of any kind received as a consideration for the use or the right to use any copyright and does not mean that there should be an exclusive transfer to treat the consideration as 'royalty'. **Observations by Supreme Court:** • The Supreme Court referring to State of Madras v. Swastik Tobacco Factory[8] debunked the rationale of High Court with respect to the interpretation of the phrase 'in respect of'. The Supreme Court said that as far as taxation statues are concerned, the phrase 'in respect of' has to be understood as 'on' or 'attributable to' and the assigning any other meaning as done by Karnataka High Court is not called for.

[7] 2013 (2) TMI 448
[8] (1966) 3 SCR 79

			• **The Supreme Court stated that there is no other recognition of copyright outside Section 16 of Copyright Act. Hence, the reasoning of Karnataka High Court that the meaning of copyright as per Explanation 2 to Section 9(1)((vi) is applicable for determination of whether an amount is royalty was rejected. The Supreme Court held that the phrase 'copyright' has to be understood only in terms of Section 16 of Copyright and Explanation 2 to Section 9(1)(vi) may be a sub-set to that but cannot go beyond the former.** • The Supreme Court also held that when a copyrighted article is sold, the end-user gets the right to use the intellectual property rights embodied in the copyright which would therefore amount to transfer of exclusive right of the copyright owner in the work, is also wholly incorrect.
6	HC [Delhi]	Ericsson A.B [9] (India –Sweden DTAA) **(Approved by SC)**	• The facts in this matter were, the assessee was a company incorporated in Sweden which entered into agreement with Indian cellular operators, pursuant to which the assessee supplied various equipments (hardware) embedded with software. • The revenue demanded that the Indian cellular operators would have deducted tax on payments made because the equipment also had a component of software and accordingly the payments made include payments in nature of 'royalty'. • The High Court rejected the stand taken by Revenue by holding that what the Indian cellular operators has received is an integrated unit, GSM, which is used for provision of services. The software embedded on the hardware unit is required to provide the services and the software cannot be used independently by the service provider. Hence, the consideration paid for the GSM cannot be split and tax can be levied on the software part. Further, the High Court held that even assuming that the consideration can be split, there is no payment in the nature of royalty, since the assessee has not transferred any right in terms of Section 14 to trigger the provisions of Section 9(1)(vi) of ITA. • The High Court also held that once the software is put on a hardware/media, the same would constitute 'goods' as held by Supreme Court in the matter of Tata Consultancy Services (supra).

[9] [2012] 343 ITR 470

7	HC [Delhi]	Nokia Networks OY[10] (India – Finland DTAA) ***(Approved by SC)***	• In this matter, the High Court held that the right to use simpliciter of a software programme itself does not constitute any transfer of copyright. The High Court also held that the retrospective amendments made vide Explanation 4 to Section 9(1)(vi) could not override what is stated in treaties, following the decision of Siemens Aktiongesellschaft[11] . The High Court following its earlier decision in Ericsson, wherein it was held that a copyrighted article does not fall within in the purview of Article 12 of DTAA, applied the same in this matter and held that payments would not fall under the expression of 'royalty'.
8	HC [Delhi]	Infrasoft Limited[12] (India –USA DTAA) ***(Approved by SC)***	• In this decision, the High Court was seized with the facts that whether amounts paid by civil engineers in India to an assessee which was primarily engaged in business of developing and manufacturing civil engineering software, would fall in the ambit of royalty? • The Delhi High Court placed reliance on the decision of Special Bench of Tribunal in the matter of Motorola Inc [13], wherein it was held that since there was no transfer of rights as mentioned in Section 14 of Copyright Act, the payments made would not fall under the definition of royalty either under ITA or DTAA. The Special Bench held that since in the facts before them, what was granted was a non-exclusive restricted license, the same cannot be said to be the right mentioned in Section 14 of Copyright Act and therefore what the payers got was only a copyrighted article and not copyright itself. • The Delhi High Court rejected the reliance placed by Revenue on the AAR's determination in the matter of Citrix Systems (supra) by stating that one cannot have the copyright right without the copyrighted article but at the same time just because one has the copyrighted article, it does not follow that one has also the copyright.

[10] [2013] 358 ITR 259
[11] 310 ITR 320 (Bom)
[12] [2014] 264 CTR 329
[13] [2005] 147 Taxman 39 (Delhi)

			• The Delhi High Court then referring to its earlier judgments in Ericsson AB (supra) and Nokia Networks OY (supra) and AAR's determination in Dassault (supra) and Geoquest (supra) concluded that in order to qualify a payment as royalty, a distinction has to be made between the acquisition of 'copyright right' and 'copyrighted article'. **Copyright is distinct from the material object, copyrighted.** The court held that right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to copyright. **The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the definition of 'royalty'.** • The Delhi High Court has not agreed with the decision of Karnataka High Court in the matter of Samsung Electrical Co. Limited (supra) by stating that the right to make a back-up copy purely as temporary protection against loss, destruction or damages does not amount to acquiring a copyright in the software.
9	HC [Delhi]	ZTE Corporation[14] (India – China DTAA) ***(Approved by SC)***	• The Delhi High Court held that the assessee before them is the copyright proprietor, who has made available, through one time license fee, the software to its customers, this software without the hardware, which was sold, is useless. Conversely, the hardware sold by the assessee to its customers is also valueless and cannot be used without such software. The Court held that this analysis is to show that what was conveyed to its customers by the assessee bears a close resemblance to goods. The question of conveying or parting with copyright in the software would mean that the copyright proprietor has to assign it, divesting itself of the title implying that it has divested itself all the rights under Section 14. This would mean an outright sale of the copyright or assignment, under Section 18 of Act and Section 16 of Copyright Act enacts that there cannot be any other kind of right termed as 'copyright'.

[14] [2017] 392 ITR 80

Conclusions by Supreme Court	The Supreme Court has arrived at the below conclusions after reading the above judgments as under: • Copyright is an exclusive right, which is negative in nature, being a right to restrict others from doing certain acts. • Copyright is an intangible, incorporeal right, in the nature of a privilege, which is quite independent of any material substance. Ownership of copyright in a work is different from the ownership of the physical material in which the copyrighted work may happen to be embodied. An obvious example is the purchaser of a book or a CD/DVD, who becomes the owner of the physical article, but does not become the owner of the copyright inherent in the work, such copyright remaining exclusively with the owner. • Parting with copyright entails parting with the right to do any of the acts mentioned in section 14of the Copyright Act. The transfer of the material substance does not, of itself, serve to transfer the copyright therein. The transfer of the ownership of the physical substance, in which copyright subsists, gives the purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public, unless such copies are already in circulation, and the other acts mentioned in section 14 of the Copyright Act. • A licence from a copyright owner, conferring no proprietary interest on the licensee, does not entail parting with any copyright, and is different from a licence issued under section 30 of Copyright Act, which is a licence which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. Where the core of a transaction is to authorize the end-user to have access to and make use of the 'licensed' computer software product over which the licensee has no exclusive rights, no copyright is parted with and consequently, no infringement takes place, as is recognized by section 52(1)(aa) of Copyright Act. It makes no difference whether the end-user is enabled to use computer software that is customised to its specifications or otherwise. • A non-exclusive, non-transferable licence, merely enabling the use of a copyrighted product, is in the nature of restrictive conditions which are ancillary to such use, and cannot be construed as alicence to enjoy all or any of the enumerated rights mentioned in section 14 of the Copyright Act, or create any interest in any such rights so as to attract section 30 of the Copyright Act.

	• The right to reproduce and the right to use computer software are distinct and separate rights, as has been recognized in State Bank of India (supra), the former amounting to parting with copyright and the latter, in the context of non-exclusive EULAs, not being so.

Doctrine of First Sale/Principle of Exhaustion:

The Supreme Court then proceeded to analyse the concept of doctrine of first sale/principle of exhaustion. The Revenue's contention was that on the facts of the cases involved in appeal, the doctrine of first sale/principle of exhaustion would have no application inasmuch as the doctrine is not statutorily recognised in Section 14(1)(b)(ii) of Copyright Act. This being so, the revenue contended that since the distributors of copyrighted software license or sell such computer software to end-users, there would be parting of a right or interest in copyright inasmuch as such license or sale would then hit by Section 14(b)(ii).

The Supreme Court rejected the above contention by referring to Copinger and Skone James on Copyright, wherein it was stated that an important aspect of the distribution right is that it is exhausted in relation to a particular article by the first sale of that article in community by the right holder or with his consent. The Court then proceeded to refer to the judgment of Delhi High Court in the matter of Warner Bros. Entertainment v. Santosh V G[15] , wherein the concept of doctrine of first sale/principle of exhaustion was discussed. The Delhi Court vide Para 58 stated that exhaustion right is linked to the distribution right and the right to distribute objects (making them available to the public) means that such objects (or the medium on which work is fixed) are released by or with the consent of the owner as a result of the transfer of ownership. The court stated that in this way, the owner is in control of the distribution of copies since he decides the time and form in which copies are released to public. Content-wise the distribution right are to be understood as an opportunity to provide the public with copies of work and put them into a circulation, as well as to control the way the copies are used. The exhaustion of rights principle thus limits the distribution right, by excluding control over the use of copies after they have been put into circulation for the first time.

The Supreme Court after referring to the judgment of European Court of Justice in the matter of Used Soft GmbH v. Oracle International Corp[16] and judgment of United States Court of Appeal for the Ninth Circuit in matter of Verner v. Autodesk Inc[17] has concluded that the doctrine of first sale/principle of exhaustion is dependent, in the first place, upon legislation which either recognises or refuses to recognise the doctrine (thereby continuing to vest distribution right in the copyright owner, even beyond the first sale of copyrighted article). The Supreme Court stated that prior to the amendment in 2012 to Section 14(d)(ii), which deals with cinematograph film, the legislative intent is clear to refuse to recognise the doctrine of first sale. In other words, prior to amendment, the copyright owner would continue to control the distribution rights even beyond the first sale of copyrighted work. However, post 2012, the amendment dropping the phrase 'regardless of whether such copy had been sold or given on hire on

[15] [2009] SCC OnLine Del 835
[16] Case C – 128/211
[17] 621 F.3D 1102 (9th Cir.2010)

earlier occasion', the legislative intent is clear to recognise the doctrine of first sale. In other words, post amendment, the copyright owner does not continue to have the distribution right post the first sale.
In similar way, the Supreme Court stated that Section 14(b)(ii) has also been amended in 2000, to delete the phrase 'regardless of whether such copy had been sold or given on hire on earlier occasion', thereby making it clear that the tilt has been in favour of the purchaser. The Court further stated that language of Section 14(b)(ii) of Copyright Act makes it clear that is the exclusive right of the owner to sell or to give on commercial rental or offer for sale for commercial rental 'any copy of the computer programme'. The Court stated that a distributor who purchases computer software in material form and resells it to an end-user cannot be said to be within the scope of above said provision for the reason that 'any copy of computer programme' would mean that the same would apply to making the copies of the computer programme and then selling them, i.e., reproduction of the same for sale or commercial rental.

The Supreme Court stated that the object of Section 14(b)(ii) is to prohibit reproduction of the said computer programme and consequent transfer of the reproduced computer programme to subsequent acquirers/end-users. Hence, the distributor who is engaged in resale of the computer programme does not get in the way of Section 14(b)(ii). The Court concluded that once it is understood that the object of Section 14(b)(ii) is not to prohibit the sale of computer software that is 'licensed' to be sold by a distributor, but that it is to prevent copies of computer software once sold being reproduced and then transferred by way of sale or otherwise, it becomes clear that any sale by the author of a computer software to a distributor for onward sale to an end-user, cannot possibly be hit by the said provision. Accordingly, the Court concluded that the contention of Revenue that the distribution of copyrighted computer software would constitute grant of an interest in copyright under Section 14(b)(ii) cannot be accepted.

Accordingly, the Supreme Court concluded that amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for resale or use of the computer software through EULAs/distribution agreement, is not the payment of royalty for the use of copyright in the computer software and the same does not give rise to any income taxable in India. The Court held that the above conclusions would apply to all the four categories.

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