# BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX), NEW DELHI

**18th Day of March, 2010**

**PRESENT**

**Mr Justice. P.V. Reddi (Chairman)**
**Mr. J. Khosla (Member)**

**A.A.R. No. 819 of 2009**

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| Name & address of the applicant | : | Airport Authority of India,<br>Rajiv Gandhi Bhavan,<br>Safdarjung Airport,<br>New Delhi -110 003. |
| Commissioner Concerned | : | Director of Income-tax<br>(International Taxation-I),<br>New Delhi |
| Present for the applicant | : | Mr. H.P. Agrawal, FCA<br>Mr. Ashish Kumar Gupta, FCA<br>Mr. Yogesh Jain, FCA<br>Mr. Anurag Sharma, DGM, AAI |
| Present for the Department | : | Mr. Ashish Kumar, Addl.DIT<br>Range-I, New Delhi |

## R U L I N G

[By Hon'ble Chairman]

1. The applicant (hereafter referred to as 'AAI') which is a Public Sector Undertaking set up under the Airport Authority of India Act has entered into a contract dated 11/12/2007 for "Automation Upgrade for third runway at IGI Airport, New Delhi" with Raytheon Company USA, (hereafter referred to as 'Raytheon'). The contract involves Raytheon supplying hardware, software and providing services in connection with installation. The cost of software is the major component of the contract. The applicant states that all the activities under the contract should be performed

by Raytheon outside India and only some support activities relating to installation and site inspection tests are to be rendered in India. The support services are expected to last about 20 days. The contract specifically provides that the title and risk in the property (hardware and software) shall pass to AAI outside India. AAI is responsible for payment of import duties and customs clearances. As regards software and documentation, the contract grants to AAI a non-transferable, non-exclusive, royalty free licence for using the software only at Delhi. The applicant contends that the essence of the contract is only purchase of certain copyrighted software and hardware on outright basis subject to certain end-use restrictions. The applicant points out that the consideration stipulated for installation is approximately 0.10% of the total contract value. It is the case of the applicant that the amounts received by Raytheon for supply of hardware, software and support services are in the nature of business profits and would not be taxable in India in the absence of Permanent Establishment (PE) in India, having regard to the provisions of Art.7 of DTAA (Tax treaty) between India and USA. It is submitted that the payments received by Raytheon cannot be construed as giving rise to income by way of royalty and/or fees for technical services.

2. The applicant has furnished a Note on 7th Jan 2010 containing general technical information regarding the automation

upgrade system-third runway. The following facts and features of the contract are narrated:

Raytheon being the supplier of the original ATC Automation System, was engaged to execute the project for augmentation/upgradation of the ATC Automation System. Hence, the instant contract dated 11.12.2007 was executed between AAI & Raytheon.

The said contract envisages setting up of total 7 additional working positions (i.e. 5 for approach control operations and 2 for tower control operations). New hardware (including equipments and consoles) and corresponding software has been supplied by Raytheon to set up the said 7 additional working positions.

As a result of the said contract, additional new working positions have been set up, resulting in upgradation of the capabilities and capacity of the existing Automation System to cater to the increased operations on account of the 3rd runway.

The Automation System supplied under the contract broadly consists of the under mentioned items:

**Hardware**

- Consoles (i.e. the specialized furniture into which the operational equipment is fitted into)
- Equipments (i.e. the servers, printers, LAN equipment, etc.)

**Software & documentation**

Customer-off-the-shelf (COTS) software required to run the system (e.g. Acrobat Reader, Solaris operating system, Netscape, etc.)

Raytheon's ATC Automation application software (i.e. Autotrac) along with documentation.

**Installation/Services**

The copyrights in the COTS software would be belonging to the concerned party. The copyrights in Raytheon's ATC Automation application software belong to Raytheon.

The Autotrac ATC Automation software is a standardized software. However, the software requires site specific modifications/adaptations depending on the operational requirements of the concerned airport where it is installed.

The modification/adaptation would be to take into consideration factors such as, number of runways in use, number of radar sensors available, total air-space to be controlled, quantum of air traffic, etc.

Therefore, in the instant contract, the said standardized software was customized to suit the site specific requirements of the IGI Airport, New Delhi.

Raytheon has supplied the Automation System to AAI for use at Delhi Airport only. Although AAI is the owner of the installed software (customized according to its requirements), AAI does not have any right to use the software at another location. Raytheon is free to supply the standardized software (Autotrac) to AAI for other locations and also to other parties

3. The following questions are formulated by the applicant for seeking advance ruling :

(i) Whether payment received by M/s Raytheon Company under the transaction mentioned in Annexure I is liable to tax in India in the hands of the recipient non-resident US company?

(ii) Whether any tax is required to be deducted at source by the applicant on payments to be made to the recipient non-resident US company? If yes, then what is the applicable rate of withholding tax?

4. Practically, the questions raised in this application are covered by the earlier rulings of this Authority in the case of the same applicant which is reported in 304 ITR 216 and the earlier rulings in 299 ITR 102 and 273 ITR 437. We shall now refer to those rulings.

5. The applicant's authorized representative has submitted that the ruling of this Authority in so far as software is concerned, requires reconsideration in the light of subsequent exposition of law in some cases and moreover it is pointed out that hardware and

software have been imported into India after paying applicable customs duty whereas in the previous case it was not so. The factum of payment of customs duty is indicative of the fact that they were treated as goods. Reliance has been placed on *Tata Consultancy Services vs. State of A.P.* (271 ITR, 401).

5.1 The question whether there is sufficient justification to take a different view in regard to the software and support services and whether the payments made under the contract to Raytheon would legitimately fall within the scope of Art.12 of India-US Tax Treaty ("Royalties and fees for included services") will have to be considered.

6. First, we may refer briefly to the three rulings relating to the applicant (Airport Authority of India) in connection with different contracts entered into with Raytheon.

6.1. In the first case reported in 273 ITR 437, one of the items in the contract was for modifications and anomaly resolution of the software of the MATS[1] in Delhi and Mumbai. The repairs or modifications were in respect of the software etc. supplied by Raytheon in the year 1998 pursuant to a contract of 1993. The repairs of equipments (hardware) of MATS System was also the subject matter of consideration in that ruling. In regard to the hardware, it was held that there was out-right sale of hardware and

[1] Modernization of Air Traffic System

other equipments and, therefore, the income does not fall under Article 12 of India-USA Treaty dealing with 'royalty' and 'fees for included services'. It was observed that "hardware and other equipments were the subject-matter of outright sale in favour of the applicant. It follows: that in regard to repair of hardware, the payment received by Raytheon (RC) does not fall within the meaning of income from the furnishing of services as defined in Article 12. The payment would, therefore, be business profits within the meaning of para 7 of Article 7. Inasmuch admittedly RC has no permanent establishment in India, the payment will not be taxable in India in view of the provisions of Article 7 of the Treaty." That is how the payment received by Raytheon under the 'hardware repair contract' was held to be not liable to tax in India. The reasoning in that case applies a fortiori to the present case.

6.2. In regard to the software and documentation, it was observed that the applicant had acquired a right to use the same subject to certain conditions and, therefore, it was not a case of outright sale. On the point whether the payment received by Raytheon for the repair of software answered the description of 'fees for included services' within the meaning of sub-para (a) of para 4 of Article 12 of the Treaty, it was held to be so. In other words, it was held that the payment fell within the scope of sub-para (a) of para 4 of Article 12. However, sub-para (b) of para 4 of

Article 12, i.e. making available the technical knowledge, experience, etc, was held to be not applicable. Sub-para (a) of para 4 speaks of amount paid for services which are ancillary and subsidiary to the application or enjoyment of the right, property or information for which the payment described in para 3 is received. Para 3 of Article 12, it may be noted contains the definition of 'royalty'. Thus, the consideration received in providing software under the Ist contract of 1993 was viewed as 'royalty'. However, there is no discussion on this point and no specific reasons for the conclusion were given excepting a passing observation referred to in the opening sentence of this para. However, a clear conclusion has been reached.

6.3. In the 2nd ruling reported in 299 ITR 102, the nature of contract relating to software repairs is the same. Following the earlier ruling, it was observed at p.109:

> "In so far as the software maintenance support contract is concerned, this authority held that the payment received by Raytheon answers the description of "fees for included services" within the meaning of paragraph 4(a) of article 12. This finding was given on the premise that so far as software and documentation was concerned, the applicant acquired a right to use the same subject to certain conditions whereas in the case of hardware, there was an outright sale under the 1993 contract.
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> The reasons given and the ruling pronounced by the Authority in the case of the applicant itself (AAR Nos. 624 and 625 of 2003), squarely applies to the present applications as well."

6.4. In the said ruling, the question whether or not there was 'Permanent establishment' of Raytheon loomed large and it was

held that in this regard, the earlier ruling in 273 ITR did not require reconsideration on the ground that the concession made by the Department was wrong.

6.5. The 3rd ruling is reported in 304 ITR p.216. In that case, the contract with Raytheon was to provide Surveillance Situation Display Data (S-SDD). It involved delivery of software and software documentation, hardware, installation, testing and training. The cost of (customized) software, hardware and fee for installation and testing was split up. It is substantially a similar case. Almost similar clauses were there in that contract.

The following passages in that ruling may be noted :

> "As could be seen article 10.2 states that : "…these documents shall be the property of Raytheon…..The AAI shall only be entitled to use such documents and copies in connection with the operation, repair and maintenance of the automation system." Further, article 10.4 states that : "….Raytheon grants the AAI a licence on a non-transferable, non-exclusive, royalty-free basis to use the executable software code and technical documentation for use on the automation system, in addition to the software licence provided under the automation system delivered under the surveillance situation display data (S-SDD)." It is clear from the foregoing that the documents and their copies supplied under the contract to AAI are to remain the property of RC. However, AAI will have the right to use those documents for the purpose of the contract. As regards the software and technical documentation, RC has granted a licence to AAI on a non-transferable and non-exclusive basis to use the executable software code and technical documentation."
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> Thus, the licence for use of software is not royalty free as claimed by the applicant; the contract price is inclusive of consideration for royalty.
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> We have already observed from the provisions of the contract that RC has not transferred ownership in the documents and software supplied to AAI which has only been given the right to use them for the purpose and in the manner provided in the contract. It is

> significant to note that AAI has been given the non-exclusive right of use and it has no right of sale, public distribution and circulation of the computer programme delivered to it. But the contract does not contain any similar restrictions in respect of items of hardware supplied under it, which appear to have been outrightly sold to AAI. This Authority expressed such a view in (Airports Authority of India, In re [2005] 273 ITR 437 (AAR)-AAR Nos.624-625/2003 while referring to the contracts of 1993 which contained provisions very much similar to the present contract.
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> We are of the view that income relatable to the supply of documents and software under the present contract answers to the description of royalty, as the documents and software in question are copyrights which have been given to AAI for use and a licence has also been granted o AAI. Since the provisions of the Act and the DTAA are very clear on this point, no reference to the Copyright Act or to any other source appears necessary.
> We observe that in the case before us, only the right of user of copyright in software has been given to the applicant; there is no transfer of ownership in copyright."

6.6. This Authority proceeded on the basis that there was transfer of right to use intellectual property (vide observation at p.231). Then, it was held that *Tata Consultancy* case (271 ITR 401(SC) ) relied upon by the applicant's counsel to contend that software shall be treated as 'goods' and such goods have been transferred to the applicant, but not copyright, was inapplicable. The same argument has been raised by the applicant's counsel in the present case also and the same is liable to be rejected. Whether or not the floppies/disks containing software programme are goods for the purpose of Sales Tax Act was the subject-matter of discussion in that case by the Supreme Court and it has no direct bearing on the issue arising in this application.

7. Though in the 3rd ruling (304 ITR), certain reasons are given, it appears that the line of reasoning adopted by AAR in that case is apparently at variance with the latest ruling in *Dassault Systems*. In *Dassault Systems (AAR No 821/2009)*[2] case, we have exhaustively considered various aspects of copyright in the context of royalty definition in the I.T.Act and Treaty. However, it must be pointed out that in Dassault Systems, the nature of software was different. It was standardized software of special purpose which had the intrinsic potential to generate the output without any further steps being taken before it is put to use, whereas in the present case, the software of the automation system does not by itself give rise to an output which can directly be put to use. The applicant has stated that the software is customized in the sense that it requires site specific modifications/adaptations, which are done at the spot. However, this point of distinction alone would not help us to distinguish the ruling in AAI's case and in *Dassault Systems*. Suffice it to state that some of the points and legal aspects highlighted in Dassault Systems have missed the attention of this Authority and to the extent it goes against the principles laid down in the latest ruling in Dassault case, it is not safe to decide the matter on a mere reiteration of the view taken in the 3rd Airport Authority case. We have, therefore, examined the issue from a different angle and on such consideration, we reach the same

[2] Mann – AR/0002/2010 dt.29-1-2010

conclusion on the applicability of Art.12 of the Treaty, but through a different route.

8. The crucial question is: What is the real nature and substance of the contract with which we are concerned? Can it be considered to be primarily a contract for the supply of customized software or is it a contract that falls within the scope and sweep of royalty and included services dealt with under Art.12 of the India-US Treaty ? Section 9(1)(vi) & (vii) of the Income Tax Act corresponds to Art.12 of the Treaty. The royalties and fees for included services may be taxed in the contracting State in which they arise and according to the laws of that State subject to the rates prescribed therein. We may now refer to the definition of royalties in para 3(a) of Art.12 and "fees for included services" in para 4:

> **Article 12.**
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> *"3. The term "royalties" as used in this Article means :*
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> *(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and*
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> *4. For the purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:*

*(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or*

*(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."*

8.1. We are of the view that the receipts under the contract attributable to software and installation and other services are definitely covered by cl.(b) of para 4. It might also enter the arena of cl (a) of para 3 in so far as it speaks of information concerning industrial, commercial or scientific experience. We are leaving aside the question whether the transfer of any rights in the copyright of a literary/scientific work is involved in the present case. That was the point discussed in the 3rd AAI case (304 ITR 216). Independent of that issue, we are of the view that the said payments fall within the purview of Art.12 and therefore we reaffirm the conclusion reached by this Authority, though for different reasons. First, it must be noted that the contract is for automation upgrade of the existing automation system of the 3rd runway, Delhi. "Automation system" means the software system delivered to the AAI under the contract. Raytheon grants the AAI a "licence on non-transferable, non-exclusive, royalty-free basis to use the executable software code and technical documentation for use in the automation system at Delhi". (vide cl 10.4) The responsibilities of Raytheon are specified in cl.3.1 as follows :

**"3.1 Raytheon Responsibilities:**

Raytheon shall be responsible for the following scope:

- Deliverable hardware, including consoles are listed in SOW, Enclosure (2)
- System integration of Deliverable HW, Enclosure (2), with Automation system with DG-R contract (NS/DG-R/01-06) Interim Build or Final Build which ever is operational at site at the time of this contract delivery.
- Automation system integration with new co-mounted ASR/MSSR system.
- Upgraded Delhi adaptation data
- SAT/S-SAT conduct
- Remote Technical system Transition support

Then, Raytheon is bound to provide the necessary information to operate, maintain and repair the system delivered under the contract (cl 10.1). The installation is done after suitably modifying and adapting the software on physical verification and the study of various factors on ground. A site acceptance test is finally done and the procedure therefor is contained in a document. After trial testing, a Systems Manual is provided. Software as such has no value to AAI unless Raytheon in close collaboration with AAI make the system functional at all times without the presence of Raytheon's technicians. The software of the automation system is the mechanism through which the informations and inputs concerning various technical aspects based on the expertise and experience of Raytheon are made available to the AAI personnel which in turn equips them with the necessary technical skills and operational efficiency. By means of various technical services provided by Raytheon's personnel and the sharing of their technical

knowledge and experiences with AAI personnel at the time of integration with the existing system and the site acceptance test and the technical manuals and data furnished for putting the system to effective use, Raytheon is making available to AAI its technical knowledge and skills. In ultimate analysis, the recipient of service is enabled to apply the technology. Viewed from another angle, the transfer of a technical plan is also involved in devising and activating the upgraded automation system. In this context we may refer to Example 5 of the MOU concerning fees for included services appended to US-India Tax Treaty. It reads thus:

> **Example 5**
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> *Facts* :
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> An Indian firm owns inventory control software for use in its chain of retail outlets throughout India. It expands its sales operation by employing a team of travelling salesmen to travel around the countryside selling the company's wares. The company wants to modify its software to permit the salesmen to assess the company's central computers for information on what products are available in inventory and when they can be delivered. The Indian firm hires a U.S. computer programming firm to modify its software for this purpose. Are the fees which the Indian firm pays treated as fees for included services?
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> *Analysis* :
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> The fees are for included services. The US. company clearly performs a technical service for the Indian company, and it transfers to the Indian company the technical plan (i.e., the computer programme) which it has developed."

8.2. The fact that the applicant – AAI itself has not been provided with the technology for developing the software as such does not really make a difference. The expression used is: "make available technical knowledge, experience or skills". The substance of the

transaction, in our view, is rendering of technical and consultancy services which make available to AAI the technical knowledge, experience and skills possessed by Raytheon in the field and the provision of software system is only part of that exercise. The delivery of software and the specification of the cost of software cannot be viewed in isolation. Software is a part of the package of setting up upgraded automation system and as stated earlier, it has no value unless the supplier shares the technical knowledge, informations and experience with the user and suitably equip the personnel of AAI to handle the system by themselves. It needs training and imparting of valuable informations and instructions. Viewed in this background, we are of the view that the payment made towards software can be legitimately brought within the fold of Art.12(4)(b) of the Tax Treaty, if not Art.12(3). As regards installation services, there is no dispute about its taxability.

9. As regards hardware, we reiterate the view taken in the earlier rulings that the income therefrom is not taxable especially in view of specific stipulations that the title and risk in the property passed on to AAI outside India, that AAI was responsible for import duties and customs clearance and that the consignments were shipped directly to AAI at the cost of Raytheon. Though it is a moot point whether hardware supply can be disintegrated or should be treated as incidental to the main items of work undertaken by

Raytheon, we are not prepared to reconsider the view uniformly taken in all the earlier rulings.

10. The questions are therefore answered as follows:

The answer to the **1st question** is in the affirmative except in regard to the payment made to Raytheon Company for hardware and COTS software that go with the hardware which are not liable to be taxed in India. The payments for other items fall within the scope of Art.12 and therefore can be taxed in India, irrespective of the fact that Raytheon has no PE in India.

**Question no. 2** is answered in the affirmative. The applicant is liable to deduct tax at source on the payments made to Raytheon Co, other than those for hardware. The rate of withholding tax is governed by Section 115A(1)(b)(BB) which is more beneficial to the tax payer when compared to the rate prescribed in Art.12 of the Treaty.

Accordingly, ruling is given and pronounced on this the 18th day of March, 2010.

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| **(J.Khosla)** | **(P.V.Reddi)** |
| **Member** | **Chairman** |

**F.No. AAR/819/2009 Dated: ----/03/2010**

This copy is certified to be a true copy of the Ruling is sent to:-

1. The applicant.
2. The DIT (International Taxation-I) New Delhi.

**( Batsala Jha Yadav )**
**Addl. Commissioner of Income-tax**