

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "L", MUMBAI**

BEFORE SHRI N.V. VASUDEVAN, J.M. AND SHRI A.L. GEHLOT, A.M.

ITA Nos. 1462 & 1463/M/2009
(Under Section 195(2))

**Dy. Director of Income Tax
(International Taxation) – 1(1),**
Scindia House, R.No. 117,
1st Floor, N.M. road, Ballard Estate,
Mumbai – 38.

... Appellant

Vs.

M/s Avaya Global Connect Ltd.,
72, Kalpataru Synergy,
Opp. Grand Hyatt, Vakola,
Santacruz (E), Mumbai – 400 055.
(PAN – AA ACT3992M)

...Respondent

Appellant by : Mr. Manvendra Goel
Respondent by : Mr. P.J. Paridawala/
Mr. Nitesh Joshi

ORDER

PER A.L. GEHLOT, A.M.:

Both these appeals filed by the Revenue pertain to one assessee are directed against the orders of CIT(A) – XXXI, Mumbai, both passed on 04.12.2008 [under section 195(2)] of the Act. Since common issue is involved on identical set of facts, both the appeals were heard together and, therefore, a common order passed for the sake of convenience.

2. Common grounds raised by the revenue in both the appeals is reproduced below from ITA No. 1462/M/09:-

“1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in holding that the payment made to Avaya International Sales Ltd., Ireland (ASIL) in respect of activation charges is a payment for buying a standard product/software.

2. On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in holding that the payment made to

ASIL can neither be said to be as 'Royalty' nor is covered under the provisions of 'Fees for Technical Services'.

3. On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in holding that the assessee is not liable to deduct tax at source on the payment made to ASIL as the income of ASIL is not liable to tax in India for the above payment."

4. The appellant prays that the order of the ld. CIT(A) on the above grounds be set aside and that of the AO restored."

3. Briefly the facts of the case are that the Assessee, formerly known as 'Tata Telecom Ltd.', is engaged in the business of selling Converged Communication Solution to its Customers. The assessee had entered into agreement dated 20 November, 2001 with Avaya International Sales Ltd., Ireland (AISL). Under the agreement, the assessee purchases 'converged communication solution' from AISL and sells the same to the various customers in the Territory of India. The assessee explained that the converged communication solution comprises of Hardware, which is an EPABX, and standard Software loaded/embedded on the Hardware. The assessee explained that the said Hardware and Software are inextricably linked to each other. The Software consists of various features, all of which are not activated at the time of supply of Hardware. Thus, the Hardware is in a working condition without activation of remaining features. The assessee gives its customers an option to activate the remaining features as per their specific requirement. The assessee explained that these features enhance the value and functionality of the hardware and cannot operate without the hardware and are embedded in the hardware that is purchased by assessee from AISL and supplied to the Customer and it only requires activation of the same. The assessee explained that these additional features embedded in the hardware are inextricably linked to the hardware. The assessee made application for remittance of activation charges to AISL U/s 195 of the Act without deduction of tax at source and submitted that the hardware and the software are inextricably linked to each other and therefore charges for activating the enhanced features inbuilt in the hardware is not taxable as the same do not qualify as 'fees for

technical services' or 'royalty'. Further, AISL is a tax resident of Ireland. As AISL has no permanent establishment in India, therefore, the amount to be remitted to AISL would not be chargeable to tax in India as business profits in view of Article 7 of DTAA between India and Ireland.

4. The AO did not agree with the contention of the assessee that activation charges to be remitted to AISL are not taxable in India. The AO was of the view that the said payment would be chargeable to tax as fees for technical services as AISL is providing technical services to the assessee for activating enhanced features of the equipment supplied by AISL. It was also observed by the AO that the assessee upto September 2005 was making remittance to AISL after withholding tax at source @10% under the DTTA between India and Ireland. He further observed that the assessee itself had considered the above payment as fee for technical services. The AO directed the assessee to deduct tax at source @ 10% as per Article 12 of the DTAA between India and Ireland.

5. The CIT (A) examined the definition of the term 'fees for technical services' in the light of Explanation 2 to section 9(1)(vii) and Article 12 of the DTAA of India and Ireland Treaty. The CIT(A) was of the view that the provision for activation of software embedded in the hardware was part and parcel of the equipments supplied by AISL to the assessee. Since the assessee gives option to its customer to activate certain features as per their requirement, only some basic features are activated at the time of sales and the other features are activated later on as per the request of the customers. However, the software sold cannot be also be termed as customized also as no additional facility is provided and only the standard software/feature as purchased from ASIL is sold to the customers. The finding of CIT(A) is reproduced below:-

“1.3.11 Thus it is held that the activation charges paid to AISL should not be considered in isolation and should be considered as part and parcel of the equipment supplied by them to AGCL . Accordingly, in my view, such payment can be a payment for buying a standard product/software and not 'fees for technical services'. Thus, considering the provisions

of section 9(1)(vii) of the Act and on the basis of the judicial pronouncements, as cited by the appellant, the payment made under the aforesaid agreement can neither be said to be as 'royalty' nor is covered under the provisions of 'fees for technical services'. On the basis of the above, I hold that the appellant is not liable to deduct tax at source on the payment made to AISL, as the income of AISL is not liable to tax in India for above payments. Such issue was also decided by my predecessor in appeal No. CIT(A)XXXI/ Jt. DIT(IT) 1(1)/IT-93/06-07/07-08, dated 28.2.08 in favour of appellant on same set of facts. In view of above discussion and facts the ground No. 1 to 8 of the appeal are allowed in favour of appellant."

6. The learned DR relied upon the order of AO and submitted that the assessee himself made TDS but later on it was decided not to make TDS. The learned DR submitted that both the items hardware and software are different items. Additional amount paid on account of additional features is on account of technical features. The learned DR referred page 4 of CIT (A)'s order where Article 12 of DTAA between India and Ireland has been reproduced and submitted that according to that Article 12, payments made is on account of technical services. The learned DR further submitted that the cases relied upon by the CIT (A) are distinguishable on facts as such cases are decided on the facts of respective cases.

7. On the other hand, the learned AR, relied upon the order of CIT(A) and submitted that the assessee is a distributor as per the Distribution Agreement dated 20th November, 2001 entered between the assessee and AISL. The learned AR submitted that coverage communication solution comprises of hardware, which is an EPABX, and standard software loaded/embedded on the hardware. Hardware and software are inextricably linked with each other. The software consists of various features all of which are not activating charges. Hardware has got only basic features, thus, hardware is not in working condition without activation of remaining features. The learned AR submitted that option was given to customer to activate the remaining features as per their requirement. These features embedded in the hardware i.e. purchased by the assessee from AISL and supplied to the customer and it only requires activation of the same. The features enhance the value and

functionality of hardware and cannot operate without hardware. The additional features embedded in the hardware are inextricably linked to the hardware. The learned AR reiterated following submissions and the example, which was given before the CIT(A), reads as under:-

“For example, the hardware may be for Rs. 5,000 while other features may be activated for Rs. 1000 each. The customer raises a single purchase order for the hardware and the desired features. Later on separate requests are made for the purpose of activation of the desired features. AGCL raises separate invoices at the time of supply of hardware and subsequent activation of desired features. In order to activate the features, an order is placed by AGCL to the overseas supplier, AISL for provision of activation code. This activation code is then keyed by AGCL into the hardware of the customer for activating the features. The code can be keyed into the hardware of the Customer via internet (the customer has to give access to AGCL into the hardware), by visiting the customer premises or via telephone line. Since the Customer cannot use these features unless the same is activated, he is not charged for the same. But as and when the customer requires activating, the customer raises a request for activation of the same and the same is activated at a cost. The software activation charges received by AGCL from the Customer are reported as sales in its books. In view of the above, the assessee stated that, in the instance case AGCL purchases hardware, which is an EPABX, along with standard software loaded/embedded on the hardware. The assessee stated that the said software was part and parcel of the hardware supplied and was inextricably linked to each other. The assessee stated that it is making payment for the activation of the features embedded in the hardware, which is not functional without the hardware.”

8. The learned AR referred to copies of purchase docket containing purchase order from customer, invoice issued and others, copies of original purchases have been placed at pages 21 to 37 of assessee's paper book. Similarly, documents in respect of purchase of additional features, have been placed at pages 38 to 54 of assessee's paper book. The learned counsel for the assessee submitted that the payment made was in fact on account of purchase of software and not on account of technical services. The learned AR in respect of his contention relied upon the following decisions:-

1. Skycell Communications Ltd. v. Deputy Commissioner of Income-tax 251 ITR 53 (Mad)
2. Commissioner of Income-tax v. Bharti Cellular Ltd 319 ITR 139 (Del.)

9. The learned AR submitted that whether it is not the case of the AO that the amount in question is 'royalty' is not the case of the AO. It is also the submission of the learned AR that AISL has no PE; therefore, such amount is not taxable in India. The learned AR in support of his contention relied upon the decision reported in Wipro Ltd V. ITO 94 ITD 9 (Banglore)

10. In the rejoinder, the learned DR submitted that the judgment relied upon by the AR are required to be read in the light of facts of those cases, which are not similar to the case under consideration. He further submitted that each equipment has separate number, therefore, it cannot be said that it is a part of original sale of hardware.

11. We have heard the learned representatives of the parties and record perused as well as gone through the decisions cited. In brief the nature of the transactions noticed by us are that the assessee imports instruments/equipment (hardware) from AISL which contains the basic and enhanced features and sells the same to various customers in India. The equipment purchased from AISL comprises of basic features and additional features (enhanced features). The basic features would mean the call landing at the main system, forwarding the same call to an extension, Direct Call to the extension from outside, Voice Mail, Interactive Voice Recording (IVR) etc. The basic features are those features which are inbuilt in the system instrument, imported from AISL. There are certain enhanced features of ECRM, Call Centre Work Force Management, Call Satus Display, Video Conferencing etc. which add value to the features of the solution offered to the customer. The enhanced features inbuilt in the instrument (hardware) can be activated as per the requirements of the end customer. The

assessee offers end to end converge communication solution and conduct centre/CRM solution to enterprise customers. To appreciate the issue it will be useful to refer some abstracts of the invoice issued by the assessee in respect of original sale and at the time of sale of additional features. The contents of the bill when original sale was made are reproduced below from page 31 of assessee's paper book:-

Invoice item	PO Item No	Material description pricing conditions	Quantity	Price	Value
0100	100	PH1604 Definity G3S1 for Birla copper	1 EA		
		Base price of the item		1197191.28 INR	1197191.28 INR
		A/R Basic Excise		16.00%	191550.30
		A/R Education Cess		2.00%	3831.00
		Local sales tax		4.00%	55792.88
		Net value of item			1448276.55
		Total basic price			1197191.28
		Total A/R Basic Excise			191550.30
		Total A/R Education Cess			3831.00
		Total A/R Higher Education			0.00
		Item Total			1448.276.55
		Total invoice amount Advance paid			1448275.30

12. Relevant abstract of the bill on sale of additional features is reproduced from page 39 of assessee's paper book as under:-

Invoice item	PO Item No	Material description pricing conditions	Quantity	Price	Value
0100	100	PH1604 Analong Line Card (24 port)	1 EA		
		Base price of the item		90000.00 INR	90000.00
		A/R Basic Excise		14%	12000.00
		A/R Education Cess		2.00%	282.00
		A/R Secondary & Hr. ECS		1.00%	128.00
		A/R VAT Payable		4.00%	4118.12
		Additional VAT		1.00%	1028.70
		Net Value of Item			108128.80
		Total basic price			90000.00
		Total A/R Basic Excise			12,300.00
		Total A/R Education Cess			282.00
		Total A/R Higher Education			128.00
		Total VAT			4118.12
		Total additional VAT			1028.70
		Total cess on VAT			100.00
		Item Total			108128.80

		Total invoice amount Advance paid			108128.80
--	--	--------------------------------------	--	--	-----------

13. The case of the revenue is that activation charges to be remitted to AISL are on account of 'fees for technical services'. The contention of the assessee is that the payment is nothing but part and parcel of the sale price of the original product sold. Whether the impugned payment is on account of 'fees for technical services' or not, for that purpose, we have to examine the relevant provision of IT Act as well as relevant Article of DTAA Agreement between India and Ireland. The definition of royalty and fees for technical services given in section 9(1)(vii) along with Explanation, read as under:-

"Income by way of fees for technical services payable by:

- a) The Government; or*
- b) A person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or*
- c) A person who is a non-resident, where the fees are payable in respect of services utilized in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India*
Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government;

Explanation 1. : For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposal approved by the Central Government before that date.

Explanation 2.: For the purpose of this clause 'fees for technical services' means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy service (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'salaries'.

14. The term 'fees for technical services' defined in DTAA between India and Ireland, which has been reproduced by the CIT(A) as under:-

"In terms of Article 12 of the India Ireland Treaty 'Fees for technical services' is defined as under in Article 12(3)(b)

Article 12 of the India Ireland Treaty

3(b) the term 'fees for technical services' means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personal but does not include payments for services mentioned in Articles 14 and 15 of this Convention."

15. From the relevant provisions and articles regarding terms 'fees for technical services, we find that treaty provisions of Article 12(3)(b) corresponds closely to the provisions of section 9(1)(vii) of the Income-tax Act. The meaning of technical services as given in Oxford Dictionary is adjective, as under:-

"1. of relating to a particular subject, art or craft or its techniques: technical terms (especially of a book or article) requiring special knowledge to be understood: a technical report.

2. of involving, or concerned with applied and industrial sciences: an important technical achievement.

3. resulting from mechanical failure: a technical fault.

4. according to a strict application or interpretation of the law or the rules: the arrest was a technical violation of the treaty.

Having regard to the fact that the term is required to be understood in the context in which it is used, 'fee for technical services' could only be meant to cover such things technical as are capable of being provided by way of service for a fee. The popular meaning associated with 'technical' is 'involving or concerning applied and industrial science'.

16. Explanation 2 of section 9(1)(vii) introduced by the Finance Act (No.2) with effect from April 1, 1977; products of technology had not been in such a wider use as they are today. Any construction of the provisions of the Act must be in the background of realities in day-to-day life in which the product of technology play important role in making life simpler and more convenient. In

the modern day world, every facet of one's life is linked to science and technology inasmuch as numerous things used or relied upon in every day life is the result of scientific and technological development. Every instrument or gadget that is used to make life easier is the result of scientific invention or development and involves the use of technology. On that score, every provider of every instrument or facility used by a person cannot be regarded as providing technical service. The Hon'ble Madras High Court while examining the terms 'fees for technical services' in case of Skycell Communications Ltd. Vs. DCIT, 251 ITR 53 (Mad.) quoted certain examples that *'when a person hires a taxi to move from one place to another, he uses a product of science and technology, viz., an automobile. It cannot on that ground be said that the taxi driver who controls the vehicle, and monitors its movement is rendering a technical service to the person who uses the automobile. Similarly, when a person travels by train or in an aero plane, it cannot be said that the railways or airlines is rendering a technical service to the passenger and, therefore, the passenger is under an obligation to deduct tax at source on the payments made to the railway or the airline for having used it for traveling from one destination to another. When a person travels by bus, it cannot be said that the undertaking which owns the bus service is rendering technical service to the passenger and, therefore, the passenger must deduct tax at source on the payment made to the bus service provider, for having used the bus. The electricity supplied to a consumer cannot, on the ground that generators are used to generate electricity, transmission lines to carry the power, transformers to regulate the flow of current, meters to measure the consumption, be regarded as amounting to provision of technical services to the consumer resulting in the consumer having to deduct tax at source on the payment made for the power consumed and remit the same to the revenue.'* Finally the Court held that 'technical service' referred in section 9(1)(vii) contemplates rendering of a 'service' to the payer of the fee. Mere collection of a 'fee' for use of a standard facility provided to all those willing to pay for it does not amount to the fee having been received for technical services. Similarly, the Hon'ble

Delhi High Court in the case of CIT Vs. Bharti Cellular Ltd., 319 ITR 139 (Delhi) while examining the term 'fee for technical services' held that services rendered qua interconnection/port access did not involve any human interface and, therefore, the services could not be regarded as 'technical services'. The expression 'technical service' was not to be construed in the abstract and general sense but in the narrower sense as circumscribed by the expressions 'managerial service' and 'consultancy service' as appearing in Explanation 2 to section 9(1)(vii) of the Act. The expression 'technical service' would have reference to only technical service rendered by a human. It would not include any service provided by machines or robots. The inter-connect charges/port access charges could not be regarded as fees for technical services.

17. In the light of above discussion, and consideration of facts of the case, we find that the CIT(A) has rightly held that activation charges paid to AISL are part and parcel of the equipment supplied by them to the assessee. This fact is fully supported by the facts and contents of the respective bills of which relevant abstract has been reproduced in Para 9 & 10 of this order. The detailed contents in original sale bill are name of item, base price of the item, basic excise, education cess, local sales tax and net value of the item. Similar description is found on activation charges. It is pertinent to mention that normally excise, VAT and sales tax are levied only on sale of goods and not on 'technical service' rendered. It is also not a case of the revenue that original sale was also on account of 'technical services'. There is no base at all to distinguish subsequent transaction, 'activation charges' from the original sale transaction and to be held as fees for technical services. When the nature of transaction is similar to original nature of transaction then additional activation charges were of the same colour of the original transaction, therefore, the correct nature of the transaction is sale of the product and not the fees for technical services.

18. In the result, the appeals of the Revenue are dismissed.

**Pronounced in the open court on this 20th day of August,
2010.**

Sd/-

**(N.V. VASUDEVAN)
JUDICIAL MEMBER**

Sd/-

**(A.L. GEHLOT)
ACCOUNTANT MEMBER**

Dated: 20th August, 2010

Copy to:-

- 1) *The Appellant.*
- 2) *The Respondent.*
- 3) *The CIT (A) concerned.*
- 4) *The CIT concerned.*
- 5) *The Departmental Representative, "H" Bench, I.T.A.T.,
Mumbai.*

By Order

//true copy//

*Asst. Registrar,
I.T.A.T., Mumbai.*

Kv

S.No.	Description	Date	Intls	
1.	Draft dictated on	28.7.10		Sr.P.S./P.S
2.	Draft placed before author	29.7.10		Sr.P.S/PS
3	Draft proposed & placed before the second Member			JM/AM
4	Draft discussed/approved by second Member			JM/AM
5	Approved Draft comes to the Sr.P.S./PS			Sr.P.S./P.S
6.	Kept for pronouncement on			Sr. P.S./P.S.
7.	File sent to the Bench Clerk			Sr.P.S./P.S
8	Date on which file goes to the Head Clerk			
9	Date of Dispatch of order			