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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% ***Date of decision: 14.03.2023***

\+ **W.P.(C) 3639/2022**

MILESTONE SYSTEMS A/S ..... Petitioner
Through: Mr Shashwat Bajpai with Mr Akshay Anurag and Ms Sanjana Sachdev, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE INT TAX 2(2) (1) DELHI..... Respondent
Through: Mr Sanjay Kumar, Sr. Standing Counsel.

CORAM:
HON'BLE MR JUSTICE RAJIV SHAKDHER
HON'BLE MS JUSTICE TARA VITASTA GANJU
[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.: (ORAL)

Preface:

1. This writ petition is directed against the lower withholding tax certificate dated 03.12.2021, and the undated order which is marked as Annexure-I and appended on page 278 of the case file. The said order, according to the petitioner, was received on 11.02.2022. To be noted, the Financial Year (FY) in issue is FY 2021-2022.

2. The record shows, that the petitioner had filed an application under Section 197 of the Income Tax Act, 1961 [in short, "the Act"] for being granted lower withholding tax certificate. The petitioner had sought a

certificate, at "NIL" rate of tax.

3. The impugned certificate, however, pegs the rate of tax at 9.99%. Quite obviously, the petitioner's prayer has been rejected. The reasons for rejecting the prayer made in the petitioner's application are contained in the order dated 19.05.2021.

Broad facts:

4. The petitioner is a non-resident company, incorporated under the laws of Denmark. The petitioner, admittedly, has been issued a tax residency certificate by the concerned authorities in Denmark.

4.1 It is the petitioner's case, that it is in the business of providing IP Video Management Software [hereafter referred to as "Software"] and other video surveillance related products to entities and persons across the globe. Insofar as India is concerned, the petitioner claims, that it has entered into a Distributor Partner Agreement [hereafter referred to as "Distributor Agreement"] with various companies/entities for sale of its Software.

4.2 It is the petitioner's case, that the Distributor Agreement does not confer any right of use of copyright on its partners or the end user. The petitioner claims, that all that the distributor partner acquires under the Distributor Agreement is a license to the copyrighted Software. It is, therefore, the petitioner's case, that this aspect of the matter has been considered in great detail by the Supreme Court in the judgment rendered in ***Engineering Analysis Center of Excellence Pvt. Ltd. v. Commissioner of Income Tax & Anr*** 2021 SCC OnLine SC 159.

5. Mr Shashwat Bajpai, who appears on behalf of the petitioner, says that the concerned officer, in passing the impugned order dated 19.05.2021, has side stepped a vital issue i.e., whether or not the consideration received

by the petitioner against the sale of software constituted royalty within the meaning of Section 9(1)(vi) and/or Article 13(3) of the Double Taxation Avoidance Agreement (DTAA) entered into between India and Denmark.

6. Mr Sanjay Kumar, senior standing counsel, who appears on behalf of the respondent/revenue, vociferously opposes the relief claimed by the petitioner.

6.1 It is Mr Kumar's contention, that while examining an application preferred under Section 197 of the Act, the concerned officer is not carrying out an assessment, and therefore, the parameters which apply for assessing taxable income would not get triggered, while rendering a decision *qua* an application filed under the aforementioned provision.

6.2 It is also Mr Kumar's contention, that under the provisions of Section 195, deduction of withholding tax is the rule, and issuance of a lower withholding tax certificate under Section 197 of the Act is an exception.

7. It is, therefore, Mr Kumar's contention, that the rate of withholding tax indicated in the impugned certificate ought to be sustained.

Reasons:

8. We have heard the learned counsel for the parties, and examined the record. In our view, the impugned order does not deal with the core issue which arose for consideration, and was the basis on which the application had been preferred by the petitioner under Section 197 of the Act.

9. As noted hereinabove, it is the petitioner's case, that the Software sold by it to its distributor partners under the Distributor Agreement does not confer, either on the distributor partner or the reseller, the right to make use of the original copyright which vests in the petitioner. This plea was sought to be supported by the petitioner, by relying upon the judgment of the

Supreme Court in ***Engineering Analysis***, wherein *inter alia*, the Court has ruled, that consideration received on sale of copyrighted material cannot be equated with the consideration received for right to use original copyright work. Therefore, in our opinion, this central issue had to be dealt with by the concerned officer. Instead, as is evident on a perusal of paragraph 4 of the impugned order, the concerned officer has simply by-passed the aforementioned judgement of the Supreme Court by observing that the revenue has preferred a review petition, and that the same is pending adjudication.

10. According to us, as long as the judgment of the Supreme Court is in force, the concerned authority could not have side stepped the judgment, based on the fact that the review petition had been preferred. It would have been another matter, if the concerned officer had, on facts, distinguished the judgment of the Supreme Court in ***Engineering Analysis***.

10.1 That apart, in our view, the least that the concerned officer ought to have done was to, at least, broadly, look at the terms of Distributor Agreement, to ascertain as to what is the nature of right which is conferred on the distributor partner and/or the reseller.

11. We find, that there is no reference whatsoever to any of the clauses of the Distributor Agreement. The concerned officer has, instead, picked up one of the remitters i.e., the distributor partners, and made observations, which to say the least, do not meet the parameters set forth in Rule 28AA of the Income Tax Rules, 1962 [in short, "the Rules"] for estimating the income, that the petitioner may have earned in the given FY. The erroneous approach adopted by the concerned officer comes through upon a perusal of the following paragraphs of the impugned order:

> *"4. Submission of the applicant w.r.t. Engineering Analysis Centre for Excellence (P) Ltd. v. Commissioner of Income Tax is not tenable as department has preferred review petition in this case and it is pending before Hon'ble Apex Court for adjudication. Further, applicant has not provided information about M/s Inflow Technologies Pvt. Ltd. to find out whether it is acting independently or not. Further, M/s Inflow Technologies Pvt. Ltd. working as DAPE – Dependent Agent Permanent Establishment of the applicant cannot be ruled out and therefore there is a potential for DAPE which also not categorically denied by the applicant with necessary documents.*
> *5. In view of the above observation in para 4 and 197 being a premature stage for determining income for AY 2022-23 and assessment is not possible at this very point of time. On perusal of the Milestone Distributor Partner contract, it has been observed that the company is providing training, certification and other services to its distributors/customers which is in the nature of Fee for Technical services (FTS)/Royalty."*

12. Mr Kumar's argument, that at this stage, the Assessing Officer (AO) was not required to employ the statutory tools, which an AO brings into play while carrying out the assessment, is a submission with which one cannot quibble. That said, clearly, the concerned officer was required to examine the application, in the background of the parameters set forth in Rule 28AA of the Rules. Concededly, that exercise has not been carried out.

13. Insofar as Mr Kumar's argument is concerned, that reduction of withholding tax under Section 195 is the rule, it is required to be borne in mind, that deduction of withholding tax morphs into an obligation, only if the sum received is chargeable to tax. The petitioner's entire case is, that the sum that it receives under the Distributor Agreement is not chargeable to tax. It is in that context, that the petitioner has moved an application under Section 197 of the Act for being issued a certificate with "NIL" rate of withholding tax.

14. Given the foregoing, we are of the view, that the best way forward

would be to set aside the impugned certificate and the order, with a direction to the concerned officer, to revisit the application, in the light of what is indicated hereinabove. While doing so, the concerned officer will apply his mind, *inter alia*, to the terms of the Distributor Agreement, and the ratio of the judgment rendered by the Supreme Court in ***Engineering Analysis***. In this context, the provisions of Rule 28AA shall also be kept in mind.

14.1 The concerned officer will not be burdened by the fact that a review petition is pending, in respect of the judgment rendered by the Supreme Court in ***Engineering Analysis***. The concerned officer will ensure, that the re-examination of the application is carried out, at the earliest, though not later than eight weeks from the date of receipt of a copy of the judgment.

15. The writ petition is, accordingly, disposed of.

16. Parties will act based on the digitally signed copy of the judgment.

RAJIV SHAKDHER, J

TARA VITASTA GANJU, J

MARCH 14, 2023 / tr