आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'डी', अहमदाबाद।
IN THE INCOME TAX APPELLATE TRIBUNAL
" D " BENCH, AHMEDABAD

श्री टी.आर. सेन्थिल कुमार, न्यायिक सदस्य एवं
श्री मकरंद वसंत महादेवकर, लेखा सदस्य के समक्ष।

BEFORE SHRI T.R. SENTHIL KUMAR, JUDICIAL MEMBER
AND
SHRI MAKARAND V. MAHADEOKAR, ACCOUNTNAT MEMBER

आयकर अपील सं/**ITA No.1728/Ahd/2019**
निर्धारण वर्ष /**Assessment Year : 2011-12**

The Dy.CIT Circle-2(1)(1) Ahmedabad	**बनाम/** **v/s.**	Elitecore Technologies Pvt.Ltd. (Now merged with Sterlite Technolgies Limited) 904, Silicon Tower, B/h. Pariseema Building Off. C.G. Road Ahmedabad, Gujarat-380 009
स्थायी लेखा सं./**PAN: AAACE 6815G**		

(**अपीलार्थी/** Appellant)		(**प्रत्यर्थी/** Respondent)

Assessee by :	Shri Dhinal Shah, AR
Revenue by :	Shri Atul Pandey, Sr.DR

सुनवाई की तारीख/**Date of Hearing : 27/06/2024**
घोषणा की तारीख /**Date of Pronouncement: 12/07/2024**

आदेश/O R D E R

PER SHRI MAKARAND V. MAHADEOKAR, AM:

This appeal is filed by the Revenue as against the order passed by the Ld.Commissioner of Income-tax(Appeals)-10, Ahmedabad [hereinafter referred to as "the Ld.CIT(A)"], dated 04/09/2019, arising out of the assessment order passed by the Assessing Officer (AO) under section 143(3)

of the Income Tax Act, 1961 (hereinafter referred to as "the Act") dated 25/03/2015 relevant to the Assessment Year (AY) 2011-12.

Facts of the case:

2. The assessee is an Indian company incorporated in the state of Gujarat in the year 1999. The Assessee is primarily engaged in the business of development of software product and providing IT Solutions. Majorly, Assessee deals in business areas, namely Cyberoam, Crestel and 24Online, 24Online. Cyberoam business of the Assessee has been demerged into another company called Cyberoam Technologies Private Limited with effect from AY 2012-13. The name of Cyberoam Technologies Private Limited as on date has been changed to Sophos Technologies Private Limited. Now, the assessee-company is merged with Sterlite Technologies Ltd.

2.1. The Assessee filed its return of income for the A.Y. 2011-12 on 29th November 2011 declaring total income of Rs.18,70,45,719/- under the normal provisions of the Act. Thereafter, the return was selected for scrutiny assessment and notice under section 143(2) of the Act was issued. In response to the said notice, the Assessee submitted various details, explanations and submissions during the course of assessment proceedings. The Assessee received the assessment order dated 25th March 2015, under section 143(3) of the Act for the A.Y. 2011-12, wherein the Deputy Commissioner of Income-tax, Circle-2(1)(1) ("the AO") made certain additions disallowances and determined the total income of the Assessee at Rs.21,98,21,020/- as against the returned income of Rs.18,70,45,719/-.

3. Being aggrieved by the assessment order passed by the AO, the assessee preferred an appeal before the Ld.CIT(A), who passed an order u/s.250 of the Act partly allowing an appeal of the assessee.

3.1. Now, the Revenue is in appeal before us against the order of the Ld.CIT(A) on following grounds:

"1. The Ld CIT(A) has erred in law and on facts in deleting the addition of Rs.2,26,243/- made by the TPO in respect of upward adjustment u/s 92CA(3) of the Act.

2. The Ld CIT (A) has erred in law and on facts in deleting the addition of Rs 2,26,243/- made by the TPO in respect of determining Arm's Length interest rate @ 5.42% per annum using Comparable Uncontrolled Price (CUP) Method

3. The Ld CIT(A) has erred in law and on facts in deleting the disallowance of product certification expense

3.1. The Ld CIT(A) failed to appreciate that all income from whatever source derived. which accrues or arises in India is deemed to accrue or arise in India and provision of Section 195 are applicable on these payments.

3.2. The Ld CIT(A) has erred in law and on facts in not adjudicating the alternate contention of the Assessing officer on the issue of non-genuineness of the product development expenses claimed by the assessee.

4. The Ld CIT(A) has erred in law and on facts in deleting the disallowance or provision for royalty expense of Rs 1,69,66,598/- U/s 40(a) (ia) of the Act.

5. The appellant craves leave to amend alter any ground or add a new ground, which may be necessary."

On Ground Nos. 1 and 2

4. This ground pertains to upward adjustment of Rs.2,26,243/- on account interest charged to the Associated Enterprise (AE). During the year under consideration, the Assessee received interest on loan lent to AE in Bahrain, Elitecore Technologies Middle East Co. WLL. The Assessee charged interest at a rate equivalent to Prime Lending Rate of Central Bank of Bahrain as was prevalent on the date loan was provided i.e 4th January 2010. The effective rate of interest charged by the Assessee was 2.25% p.a. However, the TPO proposed to benchmark the loan transaction by taking the loan data on deals entered into by various financial institutions during the period 1st April 2010 to 31st March 2011 from borrowing corporations. Since, the TPO could not identify sufficient loan transactions in the country of Bahrain or the Middle East Asia geographical region, he adopted the loan transactions in US and Europe regions. Based on the said search, the average spread charged over LIBOR was taken as 338.93 basis points. The prevailing LIBOR rate was 0.53%. The TPO increased this spread by 100 basis points on account of country and foreign exchange risk and an additional 50 basis points towards country risk as the sovereign country rating of Bahrain was worse than USA. Accordingly, TPO computed the rate at 5.42% (0.53% + 3.3893% + 1% +0.50%). The TPO thus concluded that the Assessee had short-charged interest to the tune of 3.17% (5.42% - 2.25%) and made an addition of Rs. 2,26,243 to the amount of interest charged by the Assessee from its AE while passing the pricing assessment order.

5. The Ld.Departmental Representative (DR) contented that the assessee has not taken into account foreign exchange risk while adopting the rate of

interest based on loan analysis. He pointed out the conclusion of AO that the sovereign credit rating of Bahrain is worse than USA. The DR contented that since the risk is more AO was right in adding more spread while making an adjustment.

6. The Ld. Authorized Representative (AR) for the assessee, on the other hand, contented that the TPO has mistakenly benchmarked the transaction using loan deals of US and UK i.e. the bank rate. The AR invited our attention to the fact that the Ld.CIT(A) in his order has dealt with Rule 10B which states for adoption of most appropriate method and also applying of adjustment if the same could have material impact of the price under CUP method. He also stated that the TPO's benchmarking cannot be accepted because of geographical differences, non-comparability of ratings or the limitation of rating provided to investment grade, terms and conditions of loan instrument, etc. He argued that the Prime Lending Rate, adopted by the assessee as a basis for arriving at the benchmarking takes care of geographical and other risks as contemplated by the TPO hence making further adjustments to already benchmarked rate would amount to duplicate adjustments. He further stated that the loan was given to AE in the current financial year and there were no any adjustments made in earlier and subsequent financial years. He relied on the order of CIT(A) stating that the CIT(A) has dealt with the issue after taking into consideration all the points argued before us.

7. After considering the arguments presented by both sides and examining the relevant facts and provisions, we conclude -

(i) That, the TPO's reliance on loan data from the US and Europe for benchmarking is inappropriate given the distinct economic environments and sovereign risks associated with Bahrain.

(ii) That, the Prime Lending Rate of the Central Bank of Bahrain already incorporates regional economic factors and risks, aligning with the financial context of the Assessee's AE.

(iii) That, adding spreads for country and foreign exchange risks, as proposed by the TPO, constitutes duplicative adjustments, considering these factors are inherently reflected in the Prime Lending Rate adopted by the Assessee.

(iv) That, the CUP method, as per Rule 10B, necessitates adjustments only if they have a material impact on the price. The Prime Lending Rate's comprehensiveness negates the necessity for further adjustments.

(v) That, the Assessee's method of calculating interest has been consistently applied in previous and subsequent financial years without challenge, underscoring its reliability and appropriateness.

(vi) That, the Ld.CIT(A) has thoroughly addressed and resolved the issues raised, aligning with the principles of fair benchmarking and appropriate risk adjustments.

7.1. Based on the above findings, we uphold the Ld.CIT(A)'s order, thereby dismissing the TPO's adjustment of Rs.2,26,243/-. Thus, Ground Nos. 1 and 2 of Revenue's appeal are dismissed.

On Ground No.3

8. This ground relates to disallowance of Product Certification Expenses of Rs.60,57,180/- paid to non-resident on account of non-deduction of withholding tax u/s 195 of the Act and non-genuineness of the expenditure.

8.1 The facts are such that the assessee paid Product Certification Expenses as details below:

Sr. No.	Name of the Vendor	Amount Rs.	Country of Vendor
1	ICSA Lab	35,11,206	USA
2	Virtual Network Private Consortium	1,39,234	USA
3	West Cost Lab	12,21,396	UK
4	Network Test Inc	3,79,200	USA
5	Estech Co. Ltd	1,54,530	Korea
6	Kevin Gao	6,51,614	China
	Total	**60,57,180**	

8.2. In this regard, the assessee submitted before AO that the company is required to get its software product certified from various authorities for which product certification charges have been paid. The services include measuring and evaluating technical quality of the software product against standardized set of quality criteria against which certificate is issued. The certification charges include payment made to Virtual Private Network

Consortium ('VPNC'). The sum is paid for AES Interoperability test which assures VPN users that IPsec systems are generally interoperable with other IPsec systems when using the new AES encryption algorithm. The products from VPNC members that have passed the AES Interoperability test are listed at VPNC's website.

8.3. Payment to ISCA Lab was made to enhance and improve security implementations of network and Internet computing, which will improve commercial security and its use of appropriate security products, services, policies, techniques, and procedures. The same helps the company in enforcing overall confidence in computing and drives enhanced security measures while at the same time, decreasing the intrusion of security measures in everyday life. Certification also promotes user acceptance of increased security while improving the ease of use, and the invisible, automatic, and seamless integration of security technology in everyday computing. Further, copy of certificates issued from Estech Co. Ltd. along with Invoice raised on company was also submitted to the AO.

8.4. Payment to West Coast Labs was made for registering the company's products in the Checkmark System after testing the company's products against standards of West Coast Ltd. The Agreement entered with West Coast Labs along with invoice raised on company along with Copy of the screenshots of the websites were also submitted to the AO for reference which clearly showed that ETPL's products have been accorded the certificates.

8.5. In respect of tax deduction on the payments made to above mentioned parties, it was submitted that the services relate to certifying/ registering the product. The services have been availed from parties outside India viz. USA, UK, Korea and China. Hence, as per Section 90(2) of the Act, applying beneficial provisions of the tax treaty, it is submitted that the services rendered to ETPL are not technical nature and hence, the payments made are not covered within the definition of Fees for Technical Services as provided under the respective treaties. Further, in absence of fixed place of business of such parties in India, the payment made to them is not chargeable to tax in India even as business income.

8.6. Further, in relation to the payments made to ISCA labs, separate proceedings under section 201 of the Act had been initiated wherein the payments were held to be taxable. However, the Commissioner of Income-tax (Appeals) accepted the contentions of ETPL and held that such payments are neither taxable under the treaty nor taxable under the provisions of the Act. Copy of the said order was also submitted to the AO. Therefore, the company was not liable to deduct tax on payments made for product certification/ registration charges.

8.7. The AO was not satisfied with the reply and concluded that the expenses are not reasonable and genuine. He also concluded that since the income derived by these parties, to whom payment was made, is from the source in India, in terms of provisions of section 5(2)(b) of the Act, this income is deemed to accrue or arise in India and since the assessee has failed to withhold tax u/s 195(2), added back u/s 40(a)(i) of the Act.

8.8. The Ld.CIT(A) in his order while deciding the issue deleted the disallowance u/s 40(a)(i) of the Act. While doing so, he relied on the order of the Ld.CIT(A) case of in assessee's own proceedings u/s.201 of the Act in case for A.Y. 2007-08. In the said order, the Ld.CIT(A) concluded that providing certificates cannot be compared to providing technical services as per section 9(1)(vii) of the Act and therefore assessee is not in default. The Ld.CIT(A) also stated that in case of appeal for A.Y. 2012-13 relating to Sophos Technologies Pvt. Ltd., which was demerged from the assessee company, it was held that no tax is required to be withheld on payments made for getting the products certified.

8.9. The Ld.DR relied on the order of AO. On the other hand, the Ld.AR for the assessee relied on the order of the Ld.CIT(A) and judgement of **Hon'ble Supreme Court in case of CIT Vs. Kotak Securities Ltd. (Civil Appeal No. 3141 of 2016).** The Ld.AR also placed reliance on the decision of **Mumbai ITAT in case of TUV Bayern (India) Ltd. Vs. DCIT [2012] 23 taxmann.com 127.** The Ld.AR also objected to the conclusion of AO that the payment is not genuine and explained that all necessary documents were already submitted to AO and the same is already mentioned that in his order about the same.

8.10. It is noted that the assessee incurred Product Certification Expenses amounting to Rs.60,57,180/- paid to non-resident entities from the USA, UK, Korea, and China. Payments were made for certification services which involved evaluating and certifying the technical quality of the software product. The Ld.AR argued that the services were not of a technical nature and thus not liable for tax deduction at source under Section 195, citing the

Double Taxation Avoidance Agreements (DTAA) with respective countries. Additionally, the assessee provided extensive documentation supporting the genuineness and necessity of the expenses, including certificates, invoices, and agreements.

9. After considering the submissions, evidence, and judicial precedents, we conclude that the services rendered for product certification, which include evaluating technical quality and issuing certificates, do not fall under the definition of Fees for Technical Services as per Section 9(1)(vii) of the Act. This view is consistent with the Ld.CIT(A)'s findings and supported by the judgments cited by the Ld.AR, particularly the **Hon'ble Supreme Court decision in CIT Vs. Kotak Securities Ltd. (supra),** which clarified that routine services not involving technical knowledge do not constitute technical services and it is mere in the nature of facility offered or available. For the sake of clarity, we produce relevant part of the judgment –

> *"8. A reading of the very elaborate order of the Assessing Officer containing a lengthy discourse on the services made available by the Stock Exchange would go to show that apart from facilities of a faceless screen based transaction, a constant upgradation of the services made available and surveillance of the essential parameters connected with the trade including those of a particular/ single transaction that would lead credence to its authenticity is provided for by the Stock Exchange. All such services, fully automated, are available to all members of the stock exchange in respect of every transaction that is entered into. There is nothing special, exclusive or customised service that is rendered by the Stock Exchange. "Technical services" like "Managerial and Consultancy service" would denote seeking of services to cater to the special needs of the consumer/user as may be felt http://www.itatonline.org Page 8 8 necessary and the making of the same available by the service provider. It is the above feature that would distinguish/identify a service provided from a facility offered. While the former is special and exclusive to the seeker of the service, the latter, even if termed as a service, is available to all and would therefore stand out in distinction to the former. The service provided by the Stock Exchange for which transaction charges are paid fails to satisfy the aforesaid test of specialized, exclusive and individual requirement of the user or consumer who may approach the service provider for such assistance/service. It is only service*

of the above kind that, according to us, should come within the ambit of the expression "technical services" appearing in Explanation 2 of Section 9(1)(vii) of the Act. In the absence of the above distinguishing feature, service, though rendered, would be mere in the nature of a facility offered or available which would not be covered by the aforesaid provision of the Act."

9.1. Under the DTAA provisions, the payments for certification services rendered by entities in the USA, UK, Korea, and China are not taxable in India in the absence of a fixed place of business in India. Hence, the payments are not liable for withholding tax under Section 195 of the Act. This is further supported by the **Mumbai ITAT decision in TUV Bayern (India) Ltd. Vs. DCIT (supra),** which held that certification services are not fees for technical services under the Act or the DTAA. The relevant part of the decision is reproduced here -

"10. We have carefully considered the rival submissions and also perused the material placed on record. First of all, let us examine the nature of services and activities carried out by the assessee and the income derived by through its PE in India. The nature of assessee's activities in India have been elaborated in Annexure-2 of the reply filed before the Assessing Officer, which is not in dispute, has been explained in the following manner: -

Quality System Audits :

Quality System Audits are conducted by TUV Auditors. A Quality System Audit is conducted at the Clients site where the TUV Auditor evaluates the Clients Quality System (or Environmental System) against a prescribed International Standard (ISO 9001/2, ISO 14001, QS 9000, etc.). The Auditor only assesses whether or not the clients manufacturing practices meet the International Requirements or not. The Auditor is not permitted to provide any technical assistance or advice to the company. Based on his findings, the auditor prepares a report stating compliance for the "Certification Body" in Munich. The Certification body issues the Certificate after reviewing the report for compliance. Audits are carried out in various stages.

Pre-assessment Audit

A Pre-assessment audit is conducted to evaluate the feasibility of a successful certification audit. The company is informed whether or not they are ready for a Certification audit.

Certification Audit

The certification audit is conducted to assess the clients' conformity to an International Standard. A report is prepared and sent to Germany for review & issue of the Certificate.

Surveillance Audit

The above certificate is valid for 3 years. Audits are carried out every 6 months (or 12 months) to assess if the company is continuing to meet the International standard. Reports of the audit are sent to the "Certification Body" in Germany for review & their decision to allow the certificate validity to continue.

Certification Fees.

The certificate is issued to the client by the "Certification Body" from Germany after reviewing the Auditor's report. The Fee is charged at a flat rate to compensate the Certification Body for it's activity of reviewing the reports, including the competence of the auditor, the parameters checked by him, and if all requirements of the international standard have been met. This certificate is valid for 3 years. The fees are recovered and paid to the German Company annually.

Logo Fees

Once the client has been given a Certificate from German, it can use Logo during the validity of his certificate on marketing Materials, Advertisements, etc. Homologation Income Testing of a product according to International Regulatory Standards e.g. Safety belts etc. The Tests are witnessed by our auditors and a report of the results is sent to Germany. If the product meets the requirements specified in the International Standard, then the client receives E marking as per International Standards.

Inspection Fees

Inspection is conducted on products e.g. Pumps supplies to UNICEF to be issued in the rural areas. Inspections are carried out to Customer specifications mentioned in the Purchase Order of the product or as per a drawing. A certificate on the result of the inspection is submitted to the customer. Training Fees and Conducting Seminars Training Programs on New International Standards are provided for the

Public as well as on a private basis. These Training programs are designed to provide awareness on the latest international standards.

Annual Administration Charges

This charge is for the preparation of documents and sending to Germany.

Reimbursement of Expenses

This covers the actual expenditure incurred by the auditors for travelling, Lodging and Boarding and such other expenses."

10.1 In the light of the above mentioned services rendered, let us examine Article 12(3), 12(4) & 12(5), which define the term royalties and 'fees for technical services' in the following manner :-

"ARTICLE 12 - Royalties and Fees for Technical Services

(1) x x x x (2) x x x x

(3) The term "royalties" as used in this article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

(4) The term "fees for technical services" as used in this article means payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel, but does not include payments for services mentioned in Article 15 of this Agreement.

(5) The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical service arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply."

10.2 The assessee's case does not in any manner comes within the meaning of 'royalties', as there is no right to use of any other items described therein. Here, we are concerned with the meaning of term "fees for technical services" as given in para 4 of Article 12. The FTS has been defined as the payment of any amount in consideration of service for 'managerial' or 'technical' or 'consultancy' in nature, which is quite similar to definition given in Explanation 2 to Section 9(1)(vii). Looking to the nature of services provided by the assessee as has been described above, it is amply evident that it is mostly in the nature of 'audit work' wherein the auditors of the assessee visit the sites of the client's and evaluate the clients quality system as prescribed in International Standard for ISO 9001/2, ISO 14001, QS 9000 etc. Based on this audit work, a report is prepared which is sent to certification body to the assessee company in Munich, Germany, which provides a certificate for a certain period, after reviewing the report and several stages of audit work which has been carried out for this purpose. Nowhere from such services, it can be inferred that the assessee has been providing technical, managerial or consultancy services. Technical services require expertise in technology and providing the client such technical expertise which in this case no technology is transferred. Managerial services is used in the context of running and management of the business of the client, which herein this case, there is no management of client's business, but evaluation of standards as per international guidelines. Consultancy is to be understood as advisory services wherein necessary advise and consultation is given to its clients for the purpose of client's business. In an audit work there may be some incidence of advise at the time of evaluation but certainly it cannot be termed as pure consultancy services as in the audit work the auditor has to only evaluate the quality system and environmental system.

10.3 Now, coming to the print out of the website of the assessee, provided by the Learned Senior DR, it is seen that the first kind of services mentioned therein, relates purely to audit work of ISO certification. Besides this, there are host of other services mentioned, which upto some extent can be considered to be in the nature of consultancy services. However, whether the assessee has been carrying out other services as mentioned therein besides audit for certification of ISO, is not borne out from the records as the same has neither been examined by the Assessing Officer nor by the CIT(A). Both the authorities have simply observed that even the audit work and certification work comes within the realm of FTS. From the print out of the website, it is also not very clear as to whether these kind of services were also rendered in the year 1997-1998. On the contrary in the IAF guidance note provided by the learned AR, it has been clearly prohibited that the auditor will not give any prescriptive advise or 17 ITA Nos : 4944/02, & 7588/04 consultancy as a part of an assessment, which has been noted by us in the foregoing paragraphs. This goes to prove the assessee's contention that it was not engaged in any kind of consultancy services. Thus, the entire nature of services and activities carried out

by the assessee comes within the realm of 'professional services' and not within the meaning of 'FTS' as provided in the Article 12(4) and Section 9(1)(vii). Accordingly, we hold that services rendered by the assessee company are not covered under 'fees for technical services' under Article 12 of Indo-German DTAA."

9.2. Both the judgement deals with the certification charges. Considering the facts of the case and judicial pronouncements, it can be concluded that the services rendered to the assessee for product certification, which include evaluating technical quality and issuing certificates, do not fall under the definition of Fees for Technical Services as per Section 9(1)(vii) of the Act.

9.3. The assessee provided sufficient evidence, including certificates, invoices, and agreements, to establish the genuineness and business necessity of the expenses. The AO's contention on the non-genuineness of the expenditure is not substantiated by any contradictory evidence.

9.4. Therefore, we uphold the Ld.CIT(A)'s order, deleting the disallowance of Rs.60,57,180/-. Thus, Ground No.3 of Revenue's appeal is dismissed.

Ground No. 4

10. This ground raised by the Revenue pertains to Ld.CIT(A)'s decision to deleting the disallowance of provision for royalty expenses of Rs. 1,69,66,598/- claimed by the assessee.

10.1. During the course of hearing, the Ld.DR stated that the assessee has not withheld tax u/s.195(2) of the Act in respect of a provision of

Rs.1,69,66,598/- towards royalty. He relied on the order of AO who concluded that the assessee has shifted its TDS liability to subsequent year and disallowed the amount payable as royalty u/s 40(a)(i) of the Act.

10.2. The Ld.CIT(A) deleted this addition made by AO considering the judicial pronouncements relied upon by the assessee. While doing so, he noted that –

> *"The Appellant procures software from a third party vendor on which royalty is payable to the vendor. However royalty is payable to the vendor only upon the activation of the software by the end user. However there is a time gap between the same made by the Appellant and the activation by the end user. As the sales is made / recorded by the Appellant, it is required to make the provision of royalty expenses. However the same is not immediately payable to the third party vendor as the end user has not activated the software. The Appellant during the course of proceedings has submitted that Hon'ble Ahmedabad ITAT in case of Saira Asia Interior Private Limited vS ITO [2017] [79 Taxmann.com 460] has held that withholding tax liability under the Act is an indirect liability and is wholly dependent on the existence of tax liability in the hands of the payee / recipient of income. When income embedded in a payment is not taxable under the Act, the tax withholding liability does not get triggered at all. The withholding tax provision cannot be applied in vacuum and it should be read in conjunction with the charging provisions under the Act, read with the provisions of the tax treaty. Under the provisions of the tax treaty, taxability of royalty is dependent on payment by a taxpayer and receipt of the same by the Non-resident payee. Furthermore, the term "royalties" means payments of any kind "received". Thus, unless the royalty amount is actually received, taxability under the DTAA does not arise. The Appellant has procured software from the vendors located in Russia and Israel, whereas in the case if Saira Asia Interior Private Limited (supra) the vendor was in Italy."*

11. The Ld.AR for the assessee placed his reliance on order of the Ld.CIT(A), who relied on following judicial pronouncements:

1. Saira Asia Interior Private Limited Vs. ITO [2017] 79 Taxmann.com 460 (Ahmedabad ITAT).

2. Sophos Technologies Pvt. Ltd. Vs. DCIT (ITA No.1565/Ahd/2017 0 (Ahmedabad ITAT).

12. We have heard the rival contentions and perused the material available on records. We have also noted the key-points considered by the Ld.CIT(A), which states that the royalty is payable to the vendor only upon the activation of the software by the end user, which creates a time gap between the provision made by the assessee and the actual activation by the end user. The provision for royalty expenses is made at the time of recording sales, but the actual payment is not immediately due to the third-party vendor as the end user has not yet activated the software.

12.1. Judicial precedents suggest that the withholding tax liability is dependent on the existence of tax liability in the hands of the payee/recipient of income. If the income embedded in the payment is not taxable under the Act, the tax withholding liability does not arise.

12.2. In case of Saira Asia Interior Private Limited v. ITO [2017] 79 Taxmann.com 460 (Ahmedabad ITAT), the ITAT held that the withholding tax liability is an indirect liability and depends on the tax liability of the payee. If the income embedded in the payment is not taxable, the withholding tax provision does not get triggered. The withholding tax provision must be read in conjunction with the charging provisions under the Act and the tax treaty. The term "royalties" under the DTAA means payments "received," implying that unless the royalty amount is actually received, the taxability under the DTAA does not arise.

12.3. Sophos Technologies Pvt. Ltd. v. DCIT (ITA No.1565/Ahd/2017) (Ahmedabad ITAT), reinforced the principle that the withholding tax liability is contingent on the actual payment and receipt of royalty by the non-resident payee.

12.4. We, therefore, conclude that the provision for royalty expenses made by the assessee was appropriate given the business practice of recording sales and subsequently making provisions for royalty expenses due upon activation by the end user. The royalty becomes payable only when the end user activates the software, creating a legitimate time gap between the recording of sales and the actual payment.

12.5. We agree with the Ld.CIT(A) that the withholding tax liability under Section 195(2) of the Act does not arise until the royalty payment is actually due and payable. The income embedded in the payment must be taxable under the Act for the withholding tax provisions to apply. In this case, since the royalty is not immediately payable, the withholding tax liability does not get triggered.

12.6. We acknowledge the relevance of the judicial pronouncements relied upon by the Ld.CIT(A) and the assessee. The principles laid down in the cases of Saira Asia Interior Private Limited and Sophos Technologies Pvt. Ltd. support the view that the withholding tax liability is dependent on the actual receipt of payment by the non-resident payee and not merely on the provision made for such expenses.

12.7. Based on the above findings, we uphold the Ld.CIT(A)'s decision to delete the disallowance of the provision for royalty expenses amounting to Rs. 1,69,66,598/-. The AO's addition under Section 40(a)(i) is therefore not sustainable. Thus, this ground of Revenue's appeal is dismissed.

13. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in the Open Court on 12th July, 2024 at Ahmedabad.

Sd/-	**Sd/-**
(T.R. SENTHIL KUMAR)	**(MAKARAND V. MAHADEOKAR)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

अहमदाबाद/Ahmedabad, दिनांक/Dated 12/07/2024

टी.सी.नायर, व.नि.स./T.C. NAIR, Sr. PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त (अपील)/ The CIT(A)-10, Ahmedabad
5. विभागीय प्रतिनिधि,आयकर अपीलीय अधिकरण ,राजोकट/DR,ITAT, Ahmedabad,
6. गार्ड फाईल /Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

सहायक पंजीकार (Asstt. Registrar)
आयकर अपीलीय अधिकरण, ITAT, Ahmedabad