

Taxation of Software –Sale of Goods or Services- Legal Controversy

1. Introduction

Information technology services are declared services under Section 66 E (d)

“Development, design, programming, customization, adaption, upgradation, enhancement, implementation of information technology software”.

Section 65B(28) of the ACT has defined the information technology software “ **means any representation of instruction , data, sound or image, including source code or object code , recorded in machine readable form, and capable of being manipulated or providing interactivity to user, or by means of computer or an automatic data processing machine or any other device or equipment”**

The provision has been specifically included as ‘declared services’ since software has attributes of goods whether the service tax can be imposed has been a matter of argument and even litigation.

2. Software has essential characteristics of goods

In TCS vs. State of Andhra Pradesh [2005] the Supreme Court held that canned software are ‘goods’. The copyright in the program may remain with the originator of the program, but the moment copies are made and marketed , they become ‘goods’. It was held that the test to determine whether property is ‘goods for the purpose of sales tax, or is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of abstraction ,consumption and end use and whether it can be transmitted, transferred ,delivered , stored, possessed etc. in all the cases buyer is purchasing intellectual property not the media for the purpose of transfer., i.e. the paper, cassette, CD or disc. There is no distinction between branded and unbranded software. In both the cases software is capable of being abstracted, consumed and used. In both the cases software can

be transmitted, transferred ,delivered , store, possessed etc. However the supreme court had not express any opinion in case of unbranded software. Hence in case of unbranded software , the issue is not yet fully settled. **Customised and non customised software both are goods and taxable to sales tax. Infosys Technology Ltd Vs. CCT [Madras High Court]**

Software is excisable goods

Information technology software (branded as well as tailor made) is excisable goods under the heading 8523 80 20 and tariff rate of duty is 12%. However, all software except canned software [i.e. the software which can be sold off the shelf] , is exempt under Sl. no. 27 of Notification no. 6/2006- CE dated 1.3.2006.

Software is good but whether transaction is good or services has to examine ;

Software industry is disappointed as in **Infotech Software Dealer Association V. UOI** , constitutional validity of service tax on software was upheld . High Court said whether particular transaction is sale or service depend on the individual transaction. Particular transaction is exclusive sale or excusive service or both sale and service is involved depends upon the end user license agreement with ultimate customer of software. It was observed that that when software is sold through medium of internet in the form of downloadable from site , it does not fit in to ambit of 'IT software of any media' and when only password is given not CD, it does not satisfied the requirement of being goods. Further it is well settled that law is not static and technological advancement can be considered in interpreting the provision. Thus down loading of software can be considered as 'sale of goods' as technology enables such transaction.

Custom duty on Software

ITS fall under the heading 8523 80 20 of custom tariff and import of software [branded or tailor made] is not subject to custom duty. However , the excise duty is payable on branded (packaged or canned) software. Hence, CVD will be payable if package or canned software is imported.

Paper license of software and PUK cards

Documents of title conveying the right to use the information technology software [termed a paper license of software) falls under 4907 00 30 of custom tariff with duty rate of 12.5%. However, the same is exempt vide Sl. No. 157 of notification no. 21/2002 dated 1.3.2002. it

is also covered under central excise tariff under the same heading 4907 00 30 and excise duty rate is nil.

PUK [personal unlocking key] card of paper board or plastic are in the form of scratch cards .These are not document of title of software , but they contain printed matter containing numbers. PUK card is printed matter and fall under heading 4911 as other printed matter. Thus on PUK card, basic custom duty or CVD is not applicable. If imported without accompanying software – confirmed in Circular No. 15/2011. Dated 18.3.2011.

Copying software on CD is 'Manufacture'

Transforming blank CD into software loaded disc is 'manufacture'. **CIT v. Oracle Software India Ltd 2010 ELT 161 [SC]**.

Developing of Customised Software is subject to service tax

In **Sasken Communication Technology Ltd v. Jt.CCT [2011] 33 STT 507 Taxmann.com** assessee entered in to agreement its clients for development of software. Assessee provided its trained staff who developed software according to specification of customer. The assessee would have no right or claim on the software developed. Software developed shall be the absolute property of customer. It was held that this is not contract of sale of software. It is also not work contract. It is only contract for services. Therefore, transaction is liable for service tax and VAT is not applicable on this transaction.

Excise duty and service tax on software

Software falls in heading 8523 80 20 of the central excise tariff. However all software except canned software [i.e. software those can be sold off the shelf] is exempt. Duty on packaged is 12% from 17.3.2012. while there is no duty on tailor made software i.e. customized software – Sl. no. 27 of notification no. 6/2006 CE dated 1.3.2006.as amended w.e.f.27.2.2010.

Taxability of Software w.e.f 21.12.2010

Packaged or canned software falling under tariff 8523 80 20 and excise duty is payable on MRP valuation basis subject to the abatement of 15% of MRP. i.e. excise duty (and corresponding CVD in case of imported canned software) is payable on value which will be

85% of MRP printed on the canned software. Service tax will not be payable on canned software - Notification no. 53/2010 dated 21.12.2010- confirmed in MF(DR) Circular no. 15/2011, Cus, dated 18.3.2011.

SSI Unit can take benefit of the exemption

Since duty has to be paid only after exemption limit, therefore SSI can avail the exemption till limit.

Trader dealing in canned software

Traders of such software will not be liable as trading of goods cannot be subject to service tax.

Downloading of software from out of India.

Down loading software from out of India [whether tailor made or packaged] attract service tax. Because person downloading the software will be importer and liable to pay service tax under reverse charge basis method. The Place of Provision of Service Rule,2012 will have no role to play in this regard.

Renewal of license of packaged software

Sometimes the license to use the packaged software is only for one year and the license is further renewed on payment of fees by giving password. Thus packaged software is not sold. In such cases, question arises whether service tax applies or excise duty/sales tax applies.

Definition of packaged software includes 'capable of being sold of the shelf'. Thus ,by renewal of license, a software capable of being sold off the shelf ' is sale.

In case of **Infotech Software Dealer Association v. UOI [2010] 29STT 132 Madras**, High Court observed that when software is sold through medium of internet inl the form of downloadable , it does not fit in the ambit of ' IT software of any media' and then when only password is given and not CD. It does not satisfied the requirement of being goods. Further, it is well settled that the law is not static and technological advancement can be considered

in interpreting a provision. Thus , downloadable transaction of this nature can be considered as 'sale of goods' as technology enables such transaction.

Changes after 1.7.2012

- As per the definition of 'Service' as contained in clause 44 of the section 65B only those transaction are outside the ambit of service which constitutes only a transfer of title in goods or such transfers which are deemed to be sale within the meaning of clause 29A of article 366 of the Constitution. The relevant clause of transfer of right to use goods contained in sub clause [d] of clause 29A of the Constitution.
- 'Transfer of right to use goods' is deemed sale under Article 366(29A) of the constitution of India and transfer of goods by way of hiring , leasing, licensing ,or any such manner without transfer of right to use such goods is declared service under clause (f) of Section 66E.

A license to use software which does not involve the transfer of 'right to use' or would neither be a transfer of title to goods nor a deemed sale of goods. Such as activity would fall in the definition of 'service' and also in the declared service category specified in clause (f) of section 66E.

Summary of taxability of Information Technology Software

Category of Software	Excise Duty[in case Manufacture in India]	Custom Duty [In case of Imports]	Service Tax	VAT/ CST
Packaged Software with MRP	Yes	No basic but CVD and SAD	No	Yes
Packaged software where MRP not required	Excise duty on cost of media	No basic but CVD and SAD on cost	Service Tax on transfer of right to use	Yes

		of media	software	
Tailor made software	No	No	Yes	Yes
Paper License of software and PUK card	No	No	Yes	Yes
Software downloaded on internet form out of India	No	No	Yes	NA to person downloading software

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