

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 24.08.2010

CORAM

THE HONOURABLE MR.JUSTICE D.MURUGESAN
AND
THE HONOURABLE MR.JUSTICE M.SATHYANARAYANAN

W.P.Nos.3811 & 18886 of 2009

Infotech Software Dealers Association

(A society registered under the Societies
Registration Act)

12, Riddhi Siddhi, C.S.Complex
Dahisar East, Mumbai 400 068
rep.by its Authorised Signatory
Mr.Sudarsan Ranganathan ..

Petitioner in both the
Writ Petitions

-vs-

1. Union of India
Ministry of Finance
Department of Revenue
Central Board of Excise and Customs
rep. By its Secretary
North Block, New Delhi-1
2. The Chairman
Central Board of Excise and Customs
Department of Revenue
North Block
New Delhi 110 001
3. Commissioner of Service Tax
Central Board of Excise and Customs
Department of Revenue
Room No.23-A, North Block
New Delhi-14
4. Commissioner of Service Tax
6th Floor, MHU Complex
No.692, Anna Salai
Nandanam, Chennai-35 .. Respondents 1 to 4 in
both the Writ Petitions
5. Commissioner of Central Excise
6/7, ATD Street
Race Course,
Coimbatore 641 018 .. Respondent No.5 in
W.P.No.3811 of 2009

Petitions under Article 226 of The Constitution of India, praying for the issue of a Writ of Declaration to declare Section 65(105)(zzzze) of Chapter V of Finance Act, 1994 (as amended by Finance No.2 Act of 2009) as null and void and ultra vires and unconstitutional of the provisions of Articles 245, Entries 92C and 97 of List-I, Entry 54 of List-II of Schedule VII and contrary to provisions of Articles 14, 19(1)(g), 265 and 268A of the Constitution of India in so far as the petitioner is concerned.

For Petitioner :: Mr.Arvind P.Datar
Senior Counsel for
Mr.P.Giridharan

For Respondents :: Mr.M.Ravindran
Additional Solicitor
General assisted by
Mr.S.Yashwanth
Additional Central
Government
Standing Counsel

ORDER

D.MURUGESAN, J.

Both the writ petitions raise an important question as to whether a software would amount to goods and if so, when it is supplied to a customer pursuant to the "End User Licence Agreement" (EULA), the transaction is liable to be treated as sale or service and whether the Parliament has the legislative competency to bring in the amended provisions of Section 65(105)(zzzze) by virtue of the powers under Entry 97 of List I of Schedule VII of the Constitution of India?

2.1. Facts put forth by the petitioner: The petitioner in both the writ petitions is Infotech Software Dealers Association (hereinafter referred to as "the ISODA), a society registered under the Societies Registration Act with its headquarters at Mumbai. It prays for a Writ of Declaration to declare Section 65(105)(zzzze) of Chapter V of Finance Act, 1994 (as amended by Finance No.2 Act of 2009) is null and void, ultra vires and unconstitutional of the provisions of Articles 245, Entries 92C and 97 of List-I, Entry 54 of List-II of Schedule VII and contrary to provisions of Articles 14, 19(1)(g), 265 and 268A of the Constitution of India in so far as the petitioner is concerned.

2.2. The ISODA has about 100 members who are all software resellers. The members of the association of companies are engaged in the business of reselling of Computer Software Products. The sale of software by the members of the association falls into three categories. They are (i) Shrink Wrap Software; (ii) Multiple User Software/Paper Licence and (iii) Internet Download. The Shrink Wrap Software is a box containing the CD/DVD, user manual and the end user licence agreement. The box is wrapped in plastic and therefore called as "Shrink Wrap Software". When a special DVD/CD is manufactured capable of being used in more than one hardware and when the same is sold along with paper licence to enable a customer/purchaser to use the DVD/CD in a specific number of hardware equipments, it is known as "Multiple User Software or Paper Licence". In case of large number of users in different locations, it may not be

feasible to have paper licence DVD/CD and therefore the distributor with the authority of the software manufacturer enters into an agreement which enables the purchaser to download from the internet a fixed number of copies of the software, which transaction is known as "Internet Download".

2.3. The software is also classified into two types, namely, Canned Software and Customised Software. Canned software means a software that is designed and created for sale to more than one person and it is designed in such a way that large number of people can use it on a variety of hardware and it is also called as "Packaged Software" or "Standard Software" or "Normal Software" or "Branded Software". On the other hand, Customised Software means the software created for a single person or a specific customer to meet his specific requirement and it is also called as "Tailor-made Software" or "Specific Software".

2.4. Whenever software is sold in all the categories, they are treated as goods regardless of the nature of transaction. In such event, the goods are liable to sales tax and are liable to Value Added Tax (VAT). As the ultimate transaction is only that of sale of goods, an element of service is absent and in such circumstances, the State Government alone is competent to enact a law under Entry 54 of List II of Schedule VII.

2.5. Until 16.5.2008, the sale of canned software license was subject to 4% VAT and the contract for customised software maintenance and other technical support were subject to service tax. No service tax was levied in the case of sale of canned software license.

2.6. An amendment was brought to Section 65(105) of Chapter V of Finance Act, 1994 through Finance Act No.2 of 2009, whereby a new clause (zzzze) was introduced to Section 65(105). Sub-section (105) of Section 65 defines the expression "taxable service" and by virtue of the new provision of clause (zzzze), the information technology software is also brought under the meaning of "taxable service". That amendment was brought in by virtue of residuary power under Entry 97 of List I of Schedule VII. As the software being goods and there is no element of service when it is sold to the customers, the provisions of Section 65(105)(zzzze), particularly sub-clauses (v) and (vi) is unconstitutional, as it is beyond the legislative competence of Parliament.

2.7. The impugned provision is also liable to be struck down as being arbitrary and ultra vires of Article 14, as in the case of software, the right of possession as well as the effective control over the branded software is transferred to the purchaser, whereas under Section 65(105)(zzzze) (v) and (vi) of the Finance Act, the service tax has been levied only in relation to the supply of tangible goods without transfer of right of possession and effective control of tangible goods. The provision is also violative of Article 19(1)(g) and Article 265 of the Constitution of India. By virtue of the amendment, levy of service tax makes the sale of software totally unviable. As the measure and the value of tax have been done arbitrarily, particularly when the service element is absent, the levy of service tax on the value would be violative of Article 14 as well as Article 19(1)(g) of the Constitution of India.

2.8. By the imposition of service tax, the cost of the canned software to the end customer will increase by 13%. In case of VAT + service tax, it will increase to 25%. In case of import of software from abroad, the software becomes subject to levy of CVD+VAT+service tax. The amendment to the Finance Act would seriously prejudice the members of the association of companies who are the vast majority of computer

users in the country and to bear the increase in the net cost of the software by almost 25%.

3.1. Contentions of the respondents: The amendment would fall under Entry 97 of List I of Schedule VII and the challenge to the legislative competency of Parliament is totally unsustainable. All standardised software are not like any other product or goods. There is no element of sales when it is supplied to the end user by means of EULA. Along with the Standardised Software a key (an alpha numerical code) is provided to the end user to activate the software by registering the same with the original manufacturer through the internet. Standardised Software Licence licensed and available across the shelf or downloaded from internet is not a finished product, rather updates are given by the original manufacturer (Microsoft or Symantec) to the end user for an agreed period. Updates are supplied to the end user through the internet for a period specified in the license. Once the software is registered with the original manufacturer through the internet using the key supplied by the original manufacturer, (the key is nothing but an alpha numerical code) the terms of license are agreed upon and installed for use in the specific computer.

3.2. The original manufacturer, who creates the software, only licenses the software for the private use of the end user subject to the terms and conditions. If the end user agrees to the terms and conditions, such end user is given "right to use" (install, run and get updates) the software within the limits prescribed. At no stage an end user who runs the software installed in his computer becomes absolute owner of the software. The end user cannot tamper or modify, cannot improve and cannot rectify errors in the software and the end user should not sell the software to another person for commercial exploitation. In view of the specific licensing agreement between the original manufacturer of Standardised Software, namely, Microsoft and Symantec, and the end user, it would be clear that the software is not sold, but only licensed for the limited use for which it is licensed. In other words, in trade parlance, whenever a software product is launched, the original manufacturer releases what is known as End User License Agreement and Product Use Rights.

3.3. As the Right to Use includes, among other things, the three basic components, namely, (i) right to install the software in a computer by registering the same subject to licensing terms and conditions; (ii) right to run the software and (iii) right to receive updates online through the internet if and when provided by the original manufacturer, it would not amount to absolute sale. Right to Use excludes certain rights, particularly right to modify, right to work and right to commercial exploitation.

3.4. The provisions of Section 65(105)(zzzze) uses the expression providing the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products and providing the right to use information technology software supplied electronically.

3.5. The canned software or packaged software is capable of being marketed and sold off the shelf in a standardised form and therefore is excisable goods. The service element is discernible clearly in the customised software which is liable for service tax. Providing 'right to use' is a service and is liable to service tax within the ambit of constitutional mandate and residual powers of taxation. In any case, each transaction

should be considered individually to find out as to whether it is a sale or service and the writ petitions are premature, as no action is taken in terms of the amended provision.

4. We have heard Mr.Arvind P.Datar, learned senior counsel for the petitioner and Mr.M.Ravindran, learned Additional Solicitor General of India for the respondents.

5. The provisions of Section 65(105)(zzzze) reads as under:-

"Section 65: In this chapter, unless the context otherwise requires,--

(105) "taxable service" means any service provided or to be provided-

(zzzze) to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including--

(i) development of information technology software,

(ii) study, analysis, design and programming of information technology software,

(iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,

(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software.

(v) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products.

(vi) acquiring the right to use information technology software supplied electronically."

6. Amendment Act No.2 of 2009 to the Finance Act, 1994: List I of Schedule VII contains certain specific entries, where the Parliament would be competent to enact law for imposition of taxes. Some of the entries are Entry Nos.82, 85, 86, 89, 90, 92 as stood when the Constitution was framed and brought in. By the Constitution (Sixth Amendment) Act, 1956, Entry 92-A was introduced with effect from 11.6.56, which confers power on the Parliament to enact law in respect of taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce. By the Constitution (Forty-Sixth Amendment) Act, 1982, taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce was introduced with effect from 2.2.83. By the Constitution (Eighty-eighth Amendment) Act, 2003, Entry 92-C was introduced for taxes on services. Though the Amendment Bill was passed in both the Houses of Parliament, it was not given effect to. Entry 97 is a residual entry, which empowers the Parliament to

enact law in respect of any other matter not enumerated in List II or List III including any tax not mentioned in any of those lists.

7. The contention of Mr.Arvind P.Datar, learned senior counsel for the petitioner is that in view of the specific Entry 54 of List II, which empowers the State Legislature alone to enact law on taxes on the sale or purchase of goods other than newspapers subject to the provisions of Entry 92-A of the list, the amendment to the Finance Act made pursuant to the residual Entry 97 would be outside the competency of Parliament. In the event the nature of transaction is sale, the States are legislatively competent to levy sales tax on the transaction under Entry 54 of List II of Schedule VII of the Constitution. Entry 97 of List I would not be applicable if the transaction is covered by Entry 54 of List II. In that sense, the Parliament lacks competency to bring in the amendment. Mr.Datar, would further submit that inasmuch as the software is goods and the nature of transaction is nothing but a sale, the State alone has the legislative competence. In support of the proposition that the software is goods, he would rely upon the judgment of the Apex Court in *Tata Consultancy Services v. State of Andhra Pradesh*, (2005) 1 SCC 308. He would also submit that while considering the transaction, the dominant intention of the transaction would be the relevant test to determine as to whether such transaction is a sale or service. In support of the said submission, he would rely upon the judgment of the Apex Court in *Bharat Sanchar Nigam Ltd., v. Union of India and others*, (2006) 3 SCC 1.

8. We have carefully considered the rival contentions and the submissions of the respective learned senior counsel for the petitioner and the learned Additional Solicitor General for the respondents. The basic question is as to whether the provisions of Section 65(105)(zzzzz) of Chapter V of the Finance Act, 1994 (as amended by Finance No.2 Act of 2009) is within the legislative competency of the Parliament? We may also point out that so far no action has been initiated against any of the members of the petitioner-Association pursuant to the above provision. Nevertheless, as Mr. Datar, learned senior counsel had insisted the consideration of the challenge in the larger interest, we propose to discuss the rival contentions as to the validity of the provision.

9. As far as the legislative competency to make enactments in respect of the transaction which involves a sale is concerned, the State would be competent under Entry 54 of List II of Schedule VII and in such event, the Parliament may not have the legislative competency to enact law on those subjects. In respect of a transaction which is considered to be a service, no specific entry is prescribed under List I enabling the Parliament to enact law. As Entry 92-C has not yet been given effect to, the power of Parliament could be traced to the residual entry, namely, Entry 97.

10. While considering the issue in question, two incidental questions would arise, namely, whether software is goods and if so, whether in all case of transactions, it would amount to sale or in some transactions it could be considered to be a service.

11. The provisions of sub-section (105) of Section 65 relate to taxable service. It speaks of service provided or to be provided and it does not speak of any service provider, namely, the goods as such. In terms of the provisions of clause (zzzzz), any service provided or to be provided to any person or by any other person in relation to information technology software for use in the course or furtherance of business or commerce including certain specific transactions enumerated therein could be brought under taxable service. A reading of the said section does not relate to the goods as such, but

the tax to be levied only on the service already provided or the service that can be provided even at a later point of time by the re-seller. When the legislature used the expression as to the meaning of taxable service only in relation to the service provided or to be provided, that meaning cannot be extended to hold that it would mean the service provider as well. The application of the said provision must be decided depending upon the individual transaction. The only test, probably the relevant test for the Court to apply and consider is whether the impugned provision can be brought under Entry 97 of List I of Schedule VII. Inasmuch as that entry being a residuary entry and it relates to taxable service, the Parliament would certainly have the legislative competency. In this context, we may also refer to the judgment of the Apex Court in Tamil Nadu Kalyana Mandapam Association v. Union of India and others, (2004) 5 SCC 632, wherein it has been held that in the absence of any entry under List II, the Parliament would be empowered to make the law for service tax under the residuary powers in terms of Entry 97 of List I of Schedule VII.

12. Article 366(12) of the Constitution of India defines the expression "goods", which include all materials, commodities and articles. It is an inclusive definition.

13. Article 366(29A)(a) deals with a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration. On the other hand, Article 366(29A)(d) deals with a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration. The question as to whether the software is goods or not came up for consideration before the Apex Court in the decision in Tata Consultancy Services case (supra). In that case, the Apex Court was considering the provisions of the Andhra Pradesh General Sales Tax Act, 1957. Section 2(h) of the said Act defines "goods" as meaning, all kinds of movable property other than actionable claims, stocks, shares and securities and including all materials, articles and commodities including the goods involved in works contract etc. Section 2(n) of that Act defines a sale with all its grammatical variations and cognate expressions as meaning, every transfer of the property in goods, whether as such goods or in any other form in pursuance of a contract or otherwise by one person to another in the course of trade or business, for cash, or for deferred payment, or for any other valuable consideration etc. The Apex Court referred to the judgments of the American Courts in the cases of Commerce Union Bank v. Tidwell 538 S.W.2d 405; State of Alabama v. Central Computer Services, Inc. 349 So.2d 1156; First National Bank of Fort Worth v. Bob Bullock, 584 S.W.2d 548; First National Bank of Springfield v. Deptt. of Revenue, 421 NE2d 175; CompuServe, Inc. v. Lindley 535 N.E. 2D 360 and Northeast Datacom, Inc. v. City of Wallingford, 563 A2d 688 holding that 'computer software' is intangible personal property. The Apex Court also considered many other judgments of the American Courts in South Central Bell Telephone Co. v. Sidney J. Barthelemy, 643 So.2d 1240; Comptroller of the Treasury v. Equitable Trust Co., 464 A.2d 248; Chittenden Trust Co. v. Commr. of Taxes, 465 A.2d 1100; University Computing Co. v. Commissioner of Revenue for the State of Tennessee, 677 S.W.2d 445 and Hasbro Industries, Inc. v. John H. Norberg, Tax Administrator, 487 A.2d 124 taking a different view. In the above cases, it was held that when stored on magnetic tape, disc or computer chip, the software or set of instructions is physically manifested in machine-readable form by arranging electrons, by use of an electric current, to create either a magnetised or unmagnetised space. It was also held in those cases that by sale of the software program the incorporeal right to the software is not transferred since the copyright of the incorporeal right to software remains with the originator and what is sold

is a copy of the software. It was further held that the original copyright version is not the one which operates the computer of the customer but the physical copy of that software which has been transferred to the buyer. Having referred to the above judgments, the Apex Court in paragraph-19 held as follows:-

"19.Thus this Court has held that the term 'goods', for the purposes of sales tax, cannot be given a narrow meaning. It has been held that properties which are capable of being abstracted, consumed and used and/or transmitted, transferred, delivered, stored or possessed, etc. are 'goods' for the purposes of sales tax. The submission of Mr Sorabjee that this authority is not of any assistance as a software is different from electricity and that software is intellectual incorporeal property whereas electricity is not, cannot be accepted. In India the test to determine whether a property is 'goods', for purposes of sales tax, is not whether the property is tangible or intangible or incorporeal. The test is whether the item concerned is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed, etc. Admittedly in the case of software, both canned and uncanned, all of these are possible."

15. While considering the expression "goods" as used in Article 366(12) of the Constitution of India, the Apex Court has further observed as follows:

"27. In our view, the term 'goods' as used in Article 366(12) of the Constitution and as defined under the said Act is very wide and includes all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. (supra). A software program may consist of various commands which enable the computer to perform a designated task. The copyright in that program may remain with the originator of the program. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (in case of painting) or computer discs or cassettes, and marketed would become 'goods'. We see no difference between a sale of a software program on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of paintings or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction/sale of computer software is clearly a sale of 'goods' within the meaning of the term as defined in the said Act. The term 'all materials, articles and commodities' includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed, etc. The software programs have all these attributes."

The Apex Court, while considering the submission of Mr.Soli Sorabjee found that the High Court fell in error in making a distinction between branded and unbranded software and holding that branded software was goods, ultimately observed that "in both cases the software can be transmitted, transferred, delivered, stored, possessed etc. Thus even unbranded software, when it is marketed/sold, may be goods. We, however, are

not dealing with this aspect and express no opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or whether the contract is a service contract may arise." The Apex Court held that in India, the test to determine whether a property is a good for the purpose of sales tax under that Act is not whether the property is tangible or intangible or incorporeal, but whether the concerned data is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed etc. The Apex Court further held that in the software, both canned and uncanned, all the above are possible. Nevertheless, the Apex Court had left the issue as to whether even an unbranded software, when it is marketed/sold, may be goods or not undecided, as the other queries like situs of contract of sale and/or whether the contract is a service contract may arise.

16. Hon'ble Mr. Justice S.B. Sinha, while concurring with the conclusion of the Hon'ble Mr. Justice S.N. Variava for majority, considered the definition of "goods" and held as follows:-

"46. A software may be intellectual property but such personal intellectual property contained in a medium is bought and sold. It is an article of value. It is sold in various forms like floppies, disks, CD-ROMs, punch cards, magnetic tapes, etc. Each one of the mediums in which the intellectual property is contained is a marketable commodity. They are visible to the senses. They may be a medium through which the intellectual property is transferred but for the purpose of determining the question as regards levability of the tax under a fiscal statute, it may not make a difference. A program containing instructions in computer language is subject-matter of a licence. It has its value to the buyer. It is useful to the person who intends to use the hardware viz. the computer in an effective manner so as to enable him to obtain the desired results. It indisputably becomes an object of trade and commerce. These mediums containing the intellectual property are not only easily available in the market for a price but are circulated as a commodity in the market. Only because an instruction manual designed to instruct use and installation of the supplier program is supplied with the software, the same would not necessarily mean that it would cease to be a 'goods'. Such instructions contained in the manual are supplied with several other goods including electronic ones. What is essential for an article to become goods is its marketability."

While concurring with the majority view, His Lordship, however, reiterated in paragraph-50 as follows:-

"50. It is not in dispute that when a program is created it is necessary to encode it, upload the same and thereafter unload it. Indian law, as noticed by my learned Brother, Variava, J., does not make any distinction between tangible property and intangible property. A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software whether customised or non-customised satisfies these attributes, the same would be goods. Unlike the American courts, the Supreme Court of India has also not gone into the question of severability.

His Lordship also observed that under Article 366(12) of the Constitution of India, the goods include all materials, commodities and articles. The commodity is an expression of wide connotation and includes everything of use or value which can be the object of trade and commerce. His Lordship also observed that when the word "includes" is used in an interpretation clause, it must be construed as comprehending not only such things as they signify according to their nature and import, but also those things which the interpretation clause declares that they shall include. With these observations, His Lordship concurred with the findings of His Lordship S.N.Variava, J. The law on definition of goods enunciated in Tata Consultancy case was quoted with approval by the Apex Court in the judgment in Bharat Sanchar Nigam Limited and another v. Union of India and others, (2006) 3 SCC 1.

17. The law as to whether the software is goods or not is no longer res integra in view of the above dictum of the Apex Court. A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. The term 'all materials, articles and commodities' includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, delivered, stored, possessed etc. A software is an intellectual property and it is an article of value. Indian law does not recognise or make a distinction between tangible property and intangible property. A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) utility (b) capable of being bought and sold (c) capable of transmitted, transferred, delivered, stored and possessed. If a software whether customised or non-customised satisfies these attributes, the same would be goods. Unlike the American Courts, Supreme Court of India have also not gone into the question of severability.

18. This Court in the case of Infosys Technologies v. C.T.O. (2008) TIOL 509 HC Mad has held that "if the software whether customised or non-customised satisfies the Rules as a 'goods', it will also be 'goods' for the purpose of Sales Tax. Goods may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of being transmitted, transferred, delivered, stored and possessed.

19. Recently, the Karnataka High Court in the case of Antrix Corporation Ltd. v. Assistant Commissioner of Commercial Taxes & others, (2010) TIOL 515 HC KAR (February 6, 2010) has held that "as far as the definition of "goods" is concerned, in the case of Bharat Sanchar Nigam Ltd., the Apex Court approved, the definition of "goods" given in Tata Consultancy by holding that goods may be either tangible or intangible one. In 20th Century Finance Corporations case reported in MANU/SC/0412/2000, it was also clarified that, whether the goods are tangible or intangible, they must be deliverable for the purpose of sales tax, even in the context of sub-clause (d) of Clause (29A) of Article 366 of the Constitution of India. The transfer of right to use would take place, where the agreements are executed and in that context, in 20th Century Finance Corporation's case - (2000) 6 SCC 12, it was observed that delivery of goods cannot constitute the basis for levy of tax but the transfer of right to use the goods is the basis for tax. But the court emphasised that actual delivery of the goods is not necessary for effecting the transfer or right to use the goods, but the goods must be available at the time of transfer that is at the time of execution of agreement of transfer of right to use the goods, the same must be available and deliverable and when they are not deliverable, question of right to use the goods would not arise. Therefore, if there is no deliverable

goods in existence, there is no transfer of goods to the user at all. Thus, whether the goods are tangible or intangible, they must be deliverable. On the aforesaid premise, the Apex Court held that the case of State of Uttar Pradesh v. Union of India reported in (2004) 137 Src pg.620(SC), was not correctly decided. In view of the settled law, it must be held that software is 'goods' as defined in Article 366(12) of the Constitution of India.

20. This takes us to the next question as to the nature of transaction. Packaged or canned software is a software that is sold off the shelf and it can be used by more than one customer. Whenever software is not sold off the shelf, the sale price includes free initial installation and implementation of the software which also includes some modification or customisation to suit the customers without disturbing the basic structure of the software or its performances. It is relevant to note that the copyright in the software is protected and always remains the property of the creator and what is sold is the right to use the software. The sale is with a condition for exclusive use of the software by the customer at the exclusion of others and it gives absolute possession and control to the user of the right to use the software. The sale normally gives a warranty period and after the said period, some annual maintenance charges are recovered for the services rendered, popularly called as "Annual Maintenance Contract". Paragraph 8523 80 20 of the Central Excise Tariff Act covers "Information Technology Software" and attracts excise duty at the rate of 10%. Supplementary Note to Chapter 85 reads as under:

"For the purposes of heading 8523, information technology software means any representation of instructions, data, sound or image including source code and object code, recorded in a machine readable form and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine."

Notification No.6/2006 (Entry 27) provides for an exemption in respect of any customized software (that is to say any custom designed software, developed for a specific user or a client) other than packaged software or canned software. The same Entry also refers to excise duty at the rate of 12% on packaged software. The explanation defines 'packaged software or canned software' to mean a software developed to meet the needs of variety of users, and which is intended for sale or capable of being sold off the shelf.

21. Paragraph 4907 00 30 refers to documents of title conveying the right to use information technology software and attracts 10% customs duty. Serial No.157 of Notification 21/2002 refers to Chapter 49 as well as 8523 and provides for an exemption from basic customs duty in respect of (i) information technology software and (ii) document of title conveying the right to use information technology software. The Explanation to the Entry defines 'Information Technology Software' to mean any representation of instructions, data, sound or image including source code and object code, recorded in a machine readable form and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine.

22. A customised software is developed to suit the needs of a particular customer and the same cannot be used by or for any other customer. In other words, the packaged software attracts excise duty. Customised software is exempt from excise duty in terms of Notification 6 of 2006 (Entry 26). If the software is sold through the medium of internet in the form of downloadable, it does not fit into the ambit of "IT software of any media". In that event, it is possible to hold that when an access control is given through

an internet medium with a username and password and when there is no CD or other storage media for the item, it does not satisfy the requirement of being 'goods' or the entry used in the statute.

23. The software being an intangible property can be considered as goods for the purpose of levy of sales tax. However, in a transaction whereby the software is delivered to the customers, the question is as to whether it would amount to an exclusive sale. In the event if it is a case of sale, then the submission of Mr.Datar as to the legislative competency of the State Government under Entry 54 of List II must be accepted. There may be cases of exclusive sale or exclusive service or where the element of sales and service is involved. In cases where an element of service is alone involved, the Parliament has the legislative competency to enact law for levying service tax under Entry 93-C. That Entry 93-C is not notified. Hence in case if an element of service is available, the Parliament has got power to impose service tax under the residual Entry 97 of List I of VII Schedule.

24. The provisions of Section 65(53a) of the Finance Act, 1994 state as follows:-

"information technology software" means any representation of instruction, data, sound or image, including source code and object code, recorded in machine readable form and capable of being manipulated or providing interactively to a user, by means of a computer or an automatic data processing machine or any other device or equipment."

25. After the Constitution (Forty-Sixth Amendment) Act, 1982 introducing clause (29A)(d) to Article 366 of the Constitution, tax on the sale or purchase of goods includes "a tax on the transfer of the right to use any goods for any purpose whether or not for a specified period" for cash, deferred payment or other valuable consideration. The Finance Act, 2008 has brought in some new services under the service tax net. One of them is "Information Technology Software Service". The relevant amendment became effective from 16.5.2008. It was argued by Mr.Datar that after Article 366(29A)(d), even assuming that the transaction from the members of the association by delivering the software to its customer with a right to use, such transaction is deemed to be only a sale or purchase of goods. In that event, the Parliament lacks its legislative competency to bring in the amendment. In this context, we may refer to the three basic components, namely, right to install the software in a computer by registering the same subject to licensing terms and conditions, (ii) right to run the software and (iii) right to receive updates online through the internet if and when provided by the original manufacturer.

26. To decide the imposition of tax, the nature of transaction is relevant. When a statute, particularly a taxing statute is considered with reference to the legislative competency, the nature of transaction and the dominant intention on such transaction would be relevant. In the event the goods or commodity is sold as such, the transaction would fall under Entry 56 of List II of Schedule VII. However, without there being a sale of such goods, the right to use the information or the data stored in a commodity, namely, the software is transferred, whether it can be called as a sale of the commodity or the goods as such is the question to be considered. While considering the applicability of dominant test, namely, the intention of the parties, we may refer to the judgment of the Apex Court in Bharat Sanchar Nigam Limited v. Union of India, (2006) 3 SCC 1. That was a case where the Apex Court was considering the nature of transaction by which mobile phone connections are enjoyed and whether such transaction is a sale or is it a

service or is it both. With reference to Article 366(29A)(d), the Apex Court has held as follows:

"43. All the clauses of Article 366(29A) serve to bring transactions where one or more of the essential ingredients of a sale as defined in the sale of Goods Act, 1930 are absent, within the ambit of purchase and sales for the purposes of levy of sales tax. To this extent only is the principle enunciated in Gannon Dunkerly limited. The amendment especially allows specific composite contracts viz., works contracts (Clause (b)), hire purchase contracts (Clause (c)), catering contracts (Clause (e)) by legal fiction to be divisible contracts where the sale element. Gannon Dunkerley survived the 46th Constitutional Amendment in two respects. First with regard to the definition of 'sale' for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29A) operate. By introducing separate categories of 'deemed sales', the meaning of the word 'goods' was not altered. Thus the definitions of the composite elements of a sale such as intention of the parties, goods, delivery etc., would continue to be defined according to known legal connotations. This does not mean that the content of the concepts remain static. Courts must move with the times. See Attorney General v. Edison Telephone Company 1886 QBD 244. But the 46th Amendment does not give a licence for example to assume that a transaction is a sale and then to look around for what could be the goods. The word 'goods' has not been altered by the 46th Amendment. That ingredient of a sale continues to have the same definition. The second respect in which Gannon Dunkerley has survived is with reference to the dominant nature test to be applied to a composite transaction not covered by Article 366(29A). Transactions which are mutant sales are limited to the clauses of Article 366(29A). All other transactions would have to qualify as sales within the meaning of Sale of Goods Act, 1930 for the purpose of levy of sales tax.

Of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. Apart from these two cases where splitting of the service and supply has been Constitutionally permitted in clauses (b) and (g) of Clause 29A of Article 366, there is no other service which has been permitted to be so split. For example the clauses of Article 366(29A) do not cover hospital services. Therefore, if during the treatment of a patient in a hospital, he or she is given a pill, can the sales tax authorities tax the transaction as a sale? Doctors, lawyers and other professionals render service in the course of which can it be said that there is a sale of goods when a doctor writes out and hands over a prescription or a lawyer drafts a document and delivers it to his/her client? Strictly speaking with the payment of fees, consideration does pass from the patient or client to the doctor or lawyer for the documents in both cases.

44. The reason why these services do not involve a sale for the purposes of Entry 54 of List II is, as we see it, for reasons ultimately attributable to the principles enunciated in Gannon Dunkerley's case, namely, if there is an instrument of contract which may be composite in form in any case other than the exceptions in Article 366(29A), unless the transaction in truth represents two

distinct and separate contracts and is discernible as such, then the State would not have the power to separate the agreement to sell from the agreement to render service, and impose tax on the sale. The test therefore for composite contracts other than those mentioned in Article 366(29A) continues to be did the parties have in mind or intend separate rights arising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is to as what is 'the substance of the contract'. We will, for the want of a better phrase, call this the dominant nature test."

27. The dominant test applied by the Apex Court is that if there is an instrument of contract which may be composite in form in any case other than the exceptions in Article 366(29A), unless the transaction in truth represents two distinct and separate contracts and is discernible as such, then the State would not have the power to separate the agreement to sell from the agreement to render service and impose tax on the sale. The Apex Court further quoted with approval the judgment in *State of Madras v. Gannon Dunkerley and Co.(Madras) Ltd.*, IX STC 353 (SC) and held that the dominant nature test to be applied to a composite transaction not covered by Article 366(29A). While considering that Article, the Apex Court further observed that "of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. The Apex Court observed that for example, the clauses of Article 366(29A) do not cover hospital service.

28. A similar question came up for consideration before the Apex Court in *Tamil Nadu Kalyana Mandapam Association v. Union of India and others*, (2004) 5 SCC 632. The question arose for consideration was as to whether the service tax introduced vide Finance Act, 1994 pursuant to Entry 97 of List I of VII Schedule of the Constitution of India on a kalyana mantap on consideration received for allowing temporary occupation of the mantap for organising any official, social or business function and is not a tax on goods and or land, both of which are State subjects or can be brought under the residuary Entry 97 of List I. On posing a question as to whether the imposition of service tax on the service rendered by the mantap-keepers are intra vires of the Constitution and can be justified for such levy under the residuary Entry 97 of List I of VII Schedule, ultimately, held that keeping the nature of the services rendered, the Parliament did not lack legislative competency. In this regard, the Apex Court had observed as follows:

"44. In regard to the submission made on Article 366(29A)(f), we are of the view that it does not provide to the contrary. It only permits the State to impose a tax on the supply of food and drink by whatever mode it may be made. It does not conceptually or otherwise include the supply of services within the definition of sale and purchase of goods. This is particularly apparent from the following phrase contained in the said sub-article "such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods." In other words, the operative words of the said sub-article are supply of goods and it is only supply of food and drinks and other articles for human consumption that is deemed to be a sale or purchase of goods.

45. The concept of catering, admittedly, includes the concept of rendering service. The fact that tax on the sale of the goods involved in the said service

can be levied does not mean that a service tax cannot be levied on the service aspect of catering. Mr.Mohan Parasaran, learned Senior Counsel for the appellant submitted that the High Court before applying the aspect theory laid down by this Court in the case of Federation of Hotel and Restaurant Assn. Of India v. Union of India, AIR 1990 SC 1637 ought to have appreciated that in that matter Article 366(29A)(f) of the Constitution was not considered which is of vital importance to the present matter and that the High Court ought to have differentiated the two matters. In reply, our attention was invited to paras 31 and 32 of the judgment of the High Court in which service aspect was distinguished from the supply aspect. In our view, reliance placed by the High Court on Federation of Hotel and Restaurant and in particular, on the aspect theory is, therefore, apposite and should be upheld by this Court. In view of this, the contention of the appellant on this aspect is not well founded."

29. Article 366(29A)(d) is a deeming provision as to tax on the right to transfer the use of any goods for any purpose be considered as a tax on sale or purchase of goods. Even before the Amendment came into force, the customs Notification No.21 of 2002 dated 1.3.2002 referring the goods in SI.No.157 excluded the standard rate of customs for "Information Technology Software" and the document of title conveying the right to use the "Information Technology Software". SI.No.311 of the Notification relates to Compact Disc Read Only Memory (CD-ROM) prescribing Nil standard rate. Even in the budget speech 2006-07, the Hon'ble Minister for Finance has stated that customised software and software downloaded from internet will be exempt from levy of 8% excise duty on packaged software sold over the counter. The exemption from excise duty for the packaged software would be available only when sales take place. Similarly, the excise Notification dated 1.3.2006 in SI.No.27 has exempted tax for any customised software (that is to say any customised software developed for specific user or client) other than packaged software or canned software. The explanation provides that a packaged software or canned software means a software developed to meet the needs of variety of users and which is intended for sale and capable of being sold off the shelf. Similarly, in the budget speech 2008-09, the Hon'ble Minister for Finance in paragraph 151, while increasing the excise duty from 8% to 12% on packaged software to bring it on par with the customised software which will attract a service tax of 12%. Only in the above background, the amendment was brought into the Finance Act, 1994 to include "Information Technology Software" service to be a taxable service.

30. The above factor can be also taken note of to find out the nature of transaction. The Master End-User License Agreement, which is a legal agreement, states that the product is licensed through the Microsoft Developer Network Subscription Program (MSDN) and the agreement is between the MSDN and the end-user. Clause 2 of the Master End-User License Agreement (EULA) provides that for each license, one individual is authorised to use the product according to the terms of that agreement. Clause 4 of EULA relates to additional rights and limitations-general. The relevant sub-clauses under Clause 4 read as under:

"2. Termination. Without prejudice to any other rights, Microsoft may cancel this EULA if you do not abide by the terms and conditions of this EULA, in which case you must destroy all copies of the product and all of its component parts.

3. Consent To Use of Data. You agree that Microsoft and its affiliates may collect and use technical information you provide as a part of support services related to

the Product Microsoft agrees not to use this information in a form that personally identifies you.

4. Not For Resale Software. Product identified as 'Not for Resale' or "NFR" may not be resold, transferred, or used for any purpose other than demonstration, test or evaluation.

7. Software Transfer. You may permanently transfer all of your rights under this EULA, provided you retain no copies, you transfer all of the Product (including all COMPONENTS, UPDATES, the media and printed materials, any upgrades, and this EULA), you provide Microsoft notice of your name, company, and address and the name, company, and address of the person to whom you are transferring the rights granted herein, and the recipient agrees to the terms of this EULA. If the Product is an upgrade, any transfer must include all prior versions of the Product. If the Product is received as part of a subscription, any transfer must include all prior deliverables of Product and all other subscription deliverables.

9. Production Use. The Product may only be used for development purposes as described in this EULA and may not be used in a production environment, unless such use is allowed under the terms of the Component Agreement delivered with the respective COMPONENT and is not superseded by Section 3 of this EULA."

End User Licence Agreement (EULA) is also a legal contract between a software application author or publisher and the user of that application governing the usage. The agreement is renewable and/or could be amended from time to time. To find out as to whether there is an element of sale involved when software is delivered to its customer, the terms and conditions of EULA are material. Clause 1.1 of the EULA relates to installation and use. It authorises an individual to (a) install and use a copy of the software on a personal computer or other device; and (b) install an additional copy of the software on a second, portable device for the exclusive use of the primary user of the first copy of the software. Clause 1.5 of EULA relating to License Grant for Media Elements reads as under:

"The software may include certain photographs, clip art, shapes, animations, sounds, music and video clips that are identified in the software for your use (together "Media Elements"). You may also copy and modify the Media Elements, and license, display and distribute them, along with your modifications as part of your software products and services, including your web sites, but you are not licensed to do any of the following:

- you may not sell, license or distribute copies of the Media Elements by themselves or as part of any collection, product or service if the primary value of the product or service is in the Media Elements.

- you may not grant customers of your product or service any rights to license or distribute the Media Elements.

- you may not license or distribute any of the Media Elements that include representations of identifiable individuals, governments, logos, initials, emblems, trademarks, or entities for any commercial purposes or to express or imply any endorsement or association with any product, service, entity, or activity.

- you may not create obscene or scandalous works, as defined by federal law at the time the work is created, using the Media Elements. In addition, you must (a) indemnify and defend Microsoft from and against any claims or lawsuits, including attorneys' fees that arise from or result from the licensing, use or distribution of Media Elements as modified by you, and (b) include a valid copyright notice on your products and services that include the Media Elements."

31. From the above, the dominant intention of the parties would show that the developer or the creator keeps back the copyright of each software, be it canned, packaged or customised, and what is transferred to the network subscriber, namely, the members of the association, is only the right to use with copyright protection. By that agreement, even the developer does not sell the software as such. By that Master End-User License Agreement, the members of petitioner-association again enter into an End-User License Agreement for marketing the software as per the conditions stipulated therein. In common parlance, end user is a person who uses a product or utilises the service. An end user of a computer software is one who does not have any significant contact with the developer/creator/designer of the software. According to Webster's New World Telecom dictionary, an end user is "the ultimate user of a product or service, especially of a computer system, application or network." On a careful reading of the above, we are of the considered view that when a transaction takes place between the members of ISODA with its customers, it is not the sale of the software as such, but only the contents of the data stored in the software which would amount to only service. To bring the deemed sale under Article 366(29A)(d) of the Constitution of India, there must be a transfer of right to use any goods and when the goods as such is not transferred, the question of deeming sale of goods does not arise and in that sense, the transaction would be only a service and not a sale.

32. The above discussion as to the canned/packaged software or customised software is in respect of the transactions that are prevalent among the software re-sellers and their customers and the discussion is not with reference to any specific transaction. The challenge to the amended provision is only on the ground that the software is goods and all transaction would amount to sales. The said challenge is opposed on the ground that though the software is goods, the transaction may not amount to a sale in all cases and it may vary depending upon the End User Licence Agreement. As already pointed out, the Parliament has the legislative competency to bring in enactments to include certain services provided or to be provided in terms of information technology software for use in the course or furtherance of business or commerce to mean a taxable service, in terms of the residuary Entry 97 of List I of Schedule VII, the challenge to the amended provision cannot be accepted so long as the residuary power is available. However, the question as to whether a transaction would amount to sale or service depends upon the individual transaction and on that ground, the vires of a provision cannot be questioned.

33. It is the specific case of the respondents that pursuant to the amended provision, so far no demand has been raised against any of the members of the petitioner-Association and in the event such demands are made, the members of the petitioner-Association can challenge such demands depending upon the nature of transaction and may consequently resist the imposition of tax by showing that the transaction is only a sale and not a service. Therefore, we are of the considered view that the amended provision cannot be held to be unconstitutional on the ground that the Parliament lacks the legislative competency and the applicability of that provision would depend upon the

individual transactions which could be established before the authorities as and when the demand is made.

34. In view of our above findings, the challenge to the impugned provision on the ground that it is contrary to the provisions of Articles 245, 265 and 268A must fail. For the same reasons, we are not inclined to go into the other challenge with regard to Articles 14 and 19(1)(g) of the Constitution of India also.

35. For all the above reasons, we dismiss the writ petitions holding that the software is goods and whether the transaction would amount to sale or service would depend upon the individual transaction and for the reason of that challenge, the amended provision cannot be held to be unconstitutional so long as the Parliament has the legislative competency to enact law in respect of tax on service in exercise of powers under Entry 97 of List I of Schedule VII. Consequently, M.P.Nos.1 of 2009 are also dismissed. No costs.

To

1. The Secretary to Union of India
Ministry of Finance
Department of Revenue
Central Board of Excise and Customs
North Block
New Delhi-1
2. The Chairman
Central Board of Excise and Customs
Department of Revenue
North Block
New Delhi 110 001
3. Commissioner of Service Tax
Central Board of Excise and Customs
Department of Revenue
Room No.23-A, North Block
New Delhi-14
4. Commissioner of Service Tax
6th Floor, MHU Complex
No.692, Anna Salai
Nandanam, Chennai-35
5. Commissioner of Central Excise
6/7, ATD Street
Race Course
Coimbatore 641 018