

**CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
BANGALORE**

REGIONAL BENCH - COURT NO. 1

Service Tax Appeal No.2511 of 2012

(Arising out of Order-in-Original No.70/2012 dated. 30.05.2012 passed by
Commissioner of Service Tax, Bangalore)

M/s. VXL Instruments Limited,

No.17, Electronic City,
Hosur Road,
Bangalore – 560 100.

.....**Appellant(s)**

VERSUS

Commissioner of Service Tax (LTU),

16/1, 5th Floor, SP Complex,
Lalbagh Road,
Bangalore – 560027

.....**Respondent(s)**

Appearance:

Mr. Lakshmikumaran, Sr. Advocate and Mr. Syed Peeran, Advocate for
the Appellant

Mr. Rajiv Kumar Agrawal, Commissioner (AR) for the Respondent.

Coram:

Hon'ble Dr. D.M. Misra, Member (Judicial)

Hon'ble Mr. Pullela Nageswara Rao, Member (Technical)

Final Order No. 20134 /2024

Date of Hearing: 11.09.2023

Date of Decision: 06.03.2024

Per: Dr. D.M.Misra

This is an appeal filed against the Order-in-Original No. 70/2012
dated 30.05.2012 passed by the Commissioner of Service Tax, Bangalore,
wherein the Ld. Commissioner ordered as below:

- i. I classify the activity of noticee as Information Technology
service has defined under section 65(zzzze) of the Finance Act,
1994.

ii. I confirm the demand of service tax (including education cess) amounting to Rs.7,66,82,997/-(Rupees seven crores sixty six lakhs Eighty Two Thousand Nine Hundred and Ninety seven only) Under section 73(2) read with the proviso to section 73(2) of the Act.

iii. I confirm the demand of interest under the provisions of section 75 of the act on the service tax confirmed at(ii) above.

iv. I impose penalty of Rs.200/-(Rupees two hundred only) per day or @2% of the service tax, per month, whichever is higher, starting with the first day after the due date till the actual payment of the outstanding amount of service tax under section 76 of the Finance Act,1994. However, this penalty will be applicable for the period till 10.05.2008 in view of the amendment to section 78 incorporated vide Finance Bill 2008, under section 76 of the Finance Act, 1994, for their failure to discharge the appropriate service tax in accordance with the provisions of section 68 of the Act and the rules made there under.

v. I impose penalty of Rs. 5000/-under the provisions of section 77 of the Act.

vi. I impose penalty of Rs.7,66,82,997/-(Rupees seven crores sixty six lakhs Eighty Two Thousand Nine Hundred and Ninety seven only) for suppressing the fact of having provided the taxable value, suppressing the receipt of the taxable value thereof and the contravention of the provisions of the act and the rules made their under, with intent to evade payment of service tax under Section 78 of the Finance Act, 1994, which shall be reduced to 25% of the service tax confirmed provided the entire amount of service tax

along with interest and reduce penalty are paid within 30 days of the receipt of the order.

2. Briefly stated the facts of the case are that the appellants are holders of service tax registration for providing 'Maintenance and Repair Service, Erection, Commissioning and Installation Service, and Goods Transport Agency Service. Intelligence was gathered by the Department, which revealed that the appellant are manufacturer of 'Thin Client Devices and Terminals', importing certificate of authenticity (COA) which are stickers/labels that are fixed to each of the 'Thin Client Devices and Terminals' manufactured by them. The COA are exempted from customs duty and it is basically to certify the thin client devices and terminals that it contains the original software/operating systems purchased from the authorized distributors of Microsoft; this software is then embedded into the thin client devices and terminals before sale of the same. On completion of investigation, it is alleged that appellant have imported the runtime license envelope containing the runtime key and the COA, whereas only the COA otherwise known as Microsoft software license(sticker level) has been declared to the customs and imported at 'NIL' rate of duty by claiming the benefit under Sl. no. 15(ii) of the Notification no. 21/2002-Cus dated 01.03.2022; from the Microsoft OEM customer license agreement it is clear that M/s Microsoft licensing GP is 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 and inclusion in other Information technology software products to the appellant. This activity falls squarely within the definition of 'Information Technology Software Services' clause(v) of section

65(105)(zzzze) of the Finance Act 1994. Further it is alleged that the import of services is leviable to service tax under section 66A of the Finance Act, 1994, read with Taxation of Services (Provided from outside India and Received in India) Rules, 2006. Since, M/s Microsoft licensing GP does not have an office in India, the person liable to discharge the service tax as per rule 2(1)(d)(iv) of the Service Tax Rules, 1994 is the appellant. Consequently, Show Cause Notice was issued on 23.06.2011 to the appellant demanding service tax of Rs7,66,82,997/-(Rupees seven crores Sixty Six Lakhs Eighty Two Thousand Nine Hundred and Ninety seven only) for the period from 01.04.2008 to 31.03.2010 with interest and proposal for imposition of penalty. On adjudication, the demand with interest has been confirmed and penalty was imposed, mentioned as above. Hence, the present appeal.

3.1. Learned Senior advocate Shri Lakshmi Kumaran for the appellant has submitted that the appellant is an 100% EOU engaged in the manufacture of Thin Client, which is a computer with nominal storage capacity. These Thin Clients are also described as dumb terminals. Unlike personal computers (PCs), which hosts various applications, performs processing tasks and stores files locally, Thin Client does little more than transmitting keyboard and mouse inputs to the server and display the resulting output on the local screen. Out of the total production, 90% of Thin Clients are exported either directly or through merchant exporters. The Thin Clients are loaded with off the shelf packaged software i.e. Microsoft Operating System.

3.2. The appellant had entered into a 'Microsoft OEM Customer License Agreement' for embedded systems (Microsoft OEM CLA) dated 11.01.2007 with Microsoft Corporation (MS, for short), which grants them

certain non-exclusive, limited world-wide license. In pursuance to the license granted by the MS, the appellant builds (replicates) MS images using software tools from the toolkit purchased locally from the dealer of MS. They had purchased 'Microsoft Windows Embedded 2009 toolkit' from M/s. MDS Pacific Pte Ltd. Explaining the process of loading original MS software into Thin Clients, it is stated that

- a. Toolkit containing original software is loaded / on to the development machine located in the appellant's factory premises. (The toolkit installed in the development machine is used for developing runtime images).
- b. These runtime images are transferred to a master flash disc.
- c. Master flash disc is transferred to replicator machine. The replicator machine copies these images from master flash disc to any number of flash discs.
- d. These flash discs are loaded on to the thin clients manufactured by the appellant.

3.3. Further it is submitted that in terms of the agreement with MS, the appellant had to procure 'Certificate of Authenticity' (COA, for short) and affix the same on Thin Client manufactured by them. The COA are stickers / anti-piracy labels as a means to inform the customer that the software embedded into the system are authentic. During the material period, the COAs were purchased / procured on High Sea Sale (HSS, for short) basis from M/s. Priya Limited, Mumbai, who had imported the same from M/s. Daymount Limited, UK. Since purchases were made on High Sea Sale basis, the appellant had filed Bills of Entry for clearance of the product classifying the COA/stickers under Chapter 49070030 of the Schedule to the Customs Tariff Act, 1975 as documents of title conveying

right to use Information Technology Software. They have claimed exemption from customs duty being an EOU under Notification No.52/2003-Cust., dt. 31/03/2003.

3.4. Assailing the impugned order, the learned Senior Advocate has submitted that the entire proceedings is set on an incorrect premise that the appellant had procured software/right to use software and therefore liable to pay service tax under Information Technology Software Service (ITSS, for short) in terms of sub-clause (zzzze) of Section 65(105) of the Finance Act, 1994. They have submitted that the Department has misconstrued the activity of the appellant, as there is no procurement of software/right to use software and the appellant is merely procuring labels (COA) and affixing on Thin Clients manufactured by them. They have entered into one time agreement with MS which permitted to replicate software images of MS on the Thin Clients. Accordingly, they acquired a software toolkit from local authorized dealer of MS which enables them to replicate software / OS into the Thin Clients. As a means of informing the end user, the Thin Client is authentic, a sticker is affixed on each Thin Client and the said COA is non-removable, sequentially numbered and contains additional anti-piracy features. It is submitted that the COA consists of (a) serial number (b) name of software and (c) internal part of MS. COAs could be purchased only by OEM agreement holders of MS and from authorized dealers only. The appellant had procured COAs on High Sea Sales (HSS) basis from M/s. Priya Limited. They have further submitted that affixation of such COAs on the Thin Clients does not amount to import of software service nor acquiring of the software licence / right to use of the software.

3.5. Further he has submitted that once the COAs/Stickers are affixed on the Thin Client and is sold to the customers as a part of the embedded system i.e. Thin Client and no splitting of values is envisaged in the transaction with the end customer.

3.6. It is argued that the appellants purchased the COA from M/s. Priya Limited on HSS basis and filed Bill of Entry for clearance of the products classifying the same as goods under CTH 4907 00 30 and the said heading reads as "Documents of title conveying the right to use Information Technology Software". He has submitted that paper licenses are essential documents conveying the right to use IT software merit classification under CTH 4907 00 30. On the other hand, Personal Unlocking Key (PUK) cards are not documents of title conveying the right to use IT software per se but are actually printed matter containing numbers, which when entered, enable the importer to access right to use IT software and hence classifiable under CTH 4911 as 'printed matter'. In support, he has placed reliance on the following judgements:-

- i. ***Ingram Micro India Ltd. Vs. CC (Air Port & Cargo), Chennai*** [2018(364) ELT 128 (Tri. Chennai)]
- ii. ***Priya Limited Vs. CC***[2019(370) ELT 1688 (Tri. Mumbai)]
- iii. ***Hewlett Packard India Sales Pvt. Ltd. Vs. Commissioner*** [2019(9) TMI 80-CESTAT-Bangalore.

3.7. It is submitted that in the present case, the sticker labels have been examined and the Bills of Entry were assessed by the Customs Department and on receipt of the consignment being an 100% EOU, the same are bonded under the supervision of Excise officials. Therefore, all along, the Department has acknowledged the product+ labels / stickers

as 'goods'. Also the stickers have been disclosed in their annual report under the heading raw material consumption, which has been audited by the statutory auditors of the company. Further, the learned advocate has submitted that the present demand itself has been issued taking into consideration the value of the stickers reflected in the Bills of Entry; hence it is accepted as goods by the Department.

3.8. Referring to the definition and scope of ITSS under Section 65(105)(zzzze)(v) of the Finance Act, 1994, it is submitted that the said entry is limited to "right to use information software technology for commercial exploitation including right to reproduce, distribute and sell information technology software". The scope of ITSS has been explained by the Board in Circular dated 29.02.2008. He has also submitted that the right to use software is "for commercial exploitation" which would mean the transfer of producer's own right to distribute and sell the software itself to the ultimate market. In support they have referred to the judgment of the Tribunal in the case of **Infrasofttech India Ltd. Vs. CCE, Mumbai** [2021(46) GSTL 141 (Tri. Mum.)]. Further, it is submitted that the right to commercially exploit, reproduce, distribute and sell software as mentioned in the aforesaid taxable entry of ITSS under Section 65(105)(zzzze) of the Finance Act, 1994 are "copyrights" as understood under Section 14(a) and (b) of the Copyright Act, 1957. It is also clear from the Board's instruction dated 04.11.2009 that IPR portion of the cost of software was brought under the service tax net under the taxable category of ITSS.

3.9. Further, it is submitted that in the present case, the transaction is sought to be taxed is the procurement of COA/sticker, which are procured from M/s Priya Limited Bombay on high seas basis. It is required to be

affixed on the embedded system and does not grant license off the shelf packaged software under the scope of ITSS.

3.10. Rebutting the allegation at para 20 of the show cause notice, they have submitted that no licence in a document form is imported along with sticker/ labels imported in the present case, a Run Time licence also does not grant copyright licence in the software. Referring to the meaning runtime licence in the Additional Licensing Provisions with Microsoft, the learned advocate submitted that neither the COAs nor the runtime licence grant any right to reproduce or right to commercially exploit the software. At best, the runtime licence grants access rights to the software, while COA certifies the genuineness of the Microsoft software to the end customer. Further he has submitted that the cost of toolkit i.e. replicating the MS binaries to the runtime images, is negligible and incidental to the cost incurred towards obtaining the COAs. Referring to the judgment of Hon'ble Supreme Court in the case of ***Engineering Analysis Centre of Excellence Pvt. Ltd. Vs. Commissioner of Income Tax*** [2021 SCCOnline SC 159], it is submitted that a distinction between a copyright licence in a software and software licences which merely grant access right to software has been laid down. It is held that in a distributorship agreement, what is granted to the distributor is a non-exclusive, non-transferable licence to resell computer software and no copyright in the computer programme is transferred either to the distributor or to the ultimate end user. Further, it is held that when it comes to end-user to whom it directly sold the computer programme, such end user can only use it by installing it in the computer hardware owned by the end user and cannot in any manner reproduce the same for sale or transfer, contrary to the terms used in End User Licence Agreement (EULA).

Accordingly, the Hon'ble Supreme Court held that 'licence' granted under an end-user agreement is not a licence in terms of Section 30 of the Copyright Act, 1957, which transfers an interest in all or any of the rights contained in Section 14(a) and Section 14(b) of the Copyright Act, 1957 but it is a licence, which imposes condition for restriction for the use of computer software.

3.11. Referring to the judgment of the Hon'ble Supreme Court in ***SBI Vs. Collector of Customs*** [(2000) 1 SCC 727], learned advocate has submitted that differentiation was made by the Supreme Court between the right to reproduce and the right to use computer software. In the former, it would amount to a parting of copyright by the owner, whereas in the latter case, it would not. Therefore, the runtime licence like a distribution agreements do not create any interest or right on the licensee, which would amount to use of or right to use copyright but would be a licence, which means restrictions or conditions for use of software. Therefore, the transaction of import of COAs purchased from M/s. Priya Limited does not involve any licence of copyright in the software and at best it could be a software licence that grants access right to such off the shelf-packaged software. Such activity would fall outside the scope of taxable service under ITSS. Also, referring to Karnataka Value Added Tax Act, 2003, it is submitted that COAs / sticker labels affixed on the Thin Client does not confer a copyright licence in software and hence specifically covered as software licence under entry 34 of the said Act being 'goods' and not 'services'.

3.12. Refuting the confirmation of service tax demand in terms of Section 66A of the Finance Act, 1994 read with Rule 2(l)(d)(iv) of the Service Rules, 1994, the learned advocate submitted that the said provisions are

applicable only when taxable services have been received from a person outside India. Such liability cannot be fastened on a recipient in India, if the service received is not a taxable service. The procurement of the stickers / COAs are not taxable services. Further, it is submitted that the appellant had procured stickers only from M/s Priya Limited having office in Mumbai; who in turn procured them from M/s. Daymount Limited, UK; these stickers being imported by M/s Priya Limited and sold to the appellant on High Sea Sale basis and since such services have not been received from a person outside India but a person within India, hence service tax cannot be chargeable under aforesaid Section 66A read with Rule 2(l)(d)(iv) of the Service Tax Rules, 1994. The Department has not established that the appellant has made any payment for the purchase of stickers to M/s. Daymount Limited, UK.

3.13. The learned advocate further submitted that the appellant exports about 90% of their manufactured products and hence are eligible to avail cenvat credit of the service tax, if any, paid on the stickers/labels imported. Since the accumulated cenvat credit on export of the goods is eligible for cash refund under Rule 5 of CENVAT Credit Rules, 2004, therefore, the entire demand leads to a situation of revenue neutrality. In support, he relied on the following judgments:-

- i. ***CCE vs. Jamshedpur Beverages*** [2007(214) ELT 321 (SC)]
- ii. ***CCE Vs. Coca Cola India*** [2007(213) ELT 490 (SC)]
- iii. ***Air Asia India Limited Vs. Commr*** [2021(51) GSTL 310]

3.14. Further, they have submitted that the show-cause notice issued on 23.06.2011 for the period 2008-09 and 2009-10 is barred by limitation as the appellant had imported stickers / labels and filed Bills of Entry following due procedure. The goods have been examined and cleared by

Customs authorities and have been re-warehoused under the supervision of Central Excise authorities. Therefore, the activity of the appellant is within the knowledge of the Department and nothing is suppressed or misdeclared to the Department. Consequently, confirmation of demands invoking extended period of limitation is unsustainable. Also, accordingly the interest and penalty imposed under the provisions of Section 75 of the Act is also not sustainable.

4. *Per contra*, the learned AR for the Revenue has submitted that the appellants are manufacturer of Thin Client, which are loaded with Microsoft OS procured, locally. The appellant had entered into an agreement with Microsoft Corporation, which allows them to obtain COA from authorized dealers. The COAs are in the form of sticker labels. For the COA, in an invoice, a runtime key, alternatively known as the product identification key is also included. As per the agreement with Microsoft, no Thin Clients loaded with MS software could be sold without COA. Referring to the agreement between the appellant and the Microsoft Licensing GP, some of the clauses viz. COA, Runtime License Envelope, ALP, Licence Grants and Limitations of the agreement, countered the argument of the appellant that they have not imported any software or right to use software during the material period by way of neither downloading any software nor any software licence is received along with the sticker, the learned AR for the Revenue reading the definition of ITSS submitted that the COA along with runtime key are nothing but licence granted to the appellant, which allows them to sell these Thin Clients with MS operating system.

4.1. Referring to the impugned order, he has submitted that the COAs certify that the Thin Client contained original software/OS.

M/s. Daymount, UK, raised commercial invoices to M/s. Priya Ltd. for sale of these licences and these were later purchased through HSS basis by the appellant. As per the licence agreement, no Thin Client can be sold without this licence. He has submitted that the COAs provide the appellants the right to use the Microsoft OS in the Thin client and sell them. Further rebutting the argument of the appellant that labels are to be treated as 'goods', he has submitted that the Circular dated 18.03.2011 actually states that such items are 'Documents of Title' conveying the right to use software. Further he has submitted that the Circular has no relevance in the context of the present case and hence the case laws cited also of no consequence.

4.2. Further, referring to the judgment of this Tribunal in the case of ***Allegis Services (India) Pvt. Ltd. Vs. CST, Bangalore-Service Tax*** [2014(11) TMI 169 – CESTAT Bangalore], he has submitted that in the said case, it is held that the sale of licence of software is covered under ITSS. Further referring to the judgment in the case of ***Infotech Software Dealers Association Vs. UOI*** [2010(20) STR 289 (Mad.)], learned AR has submitted that whether the transaction of transfer of software licence would be a 'sale' or a 'service' was considered in the said judgment and emphasized upon the dominant nature of sale and held that such transaction cannot be treated as sale and would be only a service. Also, in support he has referred to the judgment of the Tribunal in the case of ***3I Infotech Ltd. Vs. CST, Mumbai***. Further referring to the judgment of Hon'ble Madras High court in the case of ***AGS Entertainment Pvt. Limited*** [2013(32) STR 219 (Mad.)], he has submitted that in the said case the issue for consideration was levy of service tax on copyrights. The main contention of the appellant therein

was that the transfer of copyrights, which are goods, is a transfer of right to use the goods amounting to sale and no service element is involved and temporary transfer of copy right is not exigible to service tax. Hence, there was a challenge to the vires of the levy of service tax on such transactions. After analysing the transactions, the Hon'ble High Court held that the transactions are not sale of goods and levy of service tax is not ultra vires of the constitution.

4.3. Further countering the argument of the appellant that goods being purchased from M/s. Priya Ltd., and Indian company, on High Sea Sale basis, therefore, reverse charge mechanism is not applicable, the learned AR for the Revenue has submitted that the agreement dated 11.01.2007 is between the appellant and the Microsoft for purchase of the licence. The Bills of Entry filed by the appellant stating that the supplier to be M/s. Daymount Ltd., who are located in UK and do not have any place of business in India; hence it is quite clear that the supplier remains an off shore entity and hence the appellants are correctly fastened with the service tax liability under Section 66A of Finance Act, 1994. Further, it is submitted that even, if goods were invoiced to M/s. Priya Limited, the service receiver remained with M/s. VXL i.e. the appellant. It is M/s. VXL who had entered into an agreement with M/s. Microsoft and the software is loaded by the appellant into the Thin Client and sold the same with COA.

4.4. Further, responding to the argument of revenue neutrality advanced on behalf of the Appellant, the learned AR for the Revenue referred to the judgment of the Hon'ble Supreme Court in the case of ***CCE&ST, Bangalore Vs. Northern Operating Systems*** [2022(61) GSTL 129 (SC)] and submitted the service tax liability on ITSS cannot be

ignored as the appellant would receive cash refund under Rule 5 of CENVAT Credit Rules, 2004 on import of services. Responding to the argument that the demand is barred by limitation Learned AR for the revenue has submitted that the circumstance in the present case is more or less similar to that of the judgment of the Tribunal in the case of **3I Infotech** [2018(9) TMI 1281 – CESTAT Mumbai] as the appellant had not paid service tax on the imported stickers/labels by suppressing the said facts from the knowledge of the Department. Consequently, the confirmation of demand invoking extended period, with interest and penalty is justified.

5. Heard both sides and perused the records.

6. The issues involved in the present appeal for determination are whether: (i) the purchase/import of Certificate of Authenticity(COA)/stickers/labels on high sea sale basis from M/s Priya Ltd., later affixed on the manufactured 'Thin Clients' already installed with MS software embedded system procured from local Microsoft authorized distributors, is a 'sale' or 'service' classifiable under taxable category of Information Technology Software Service (ITSS) received from M/s. Microsoft Licensing GP and accordingly chargeable to service tax under Section 66A of the Finance Act, 1994 read with Rule 2(l)(d)(iv) of the Service Tax Rules, 1994; and (ii) the demand issued on 23.06.2011 for the period from 01.04.2008 to 31.03.2010 is barred by limitation.

7. The undisputed facts are that the appellant had entered into an agreement with Microsoft titled as "Microsoft OEM Customer License Agreement for Embedded Systems" dated 11.01.2007 before the service tax levy on ITSS coming into force. As per the said agreement, they purchased/ procured off the shelf 'Windows embedded standard software

tool kit from local authorized distributor of MS viz. M/s. MDS Pacific Pte Ltd., Bangalore. The tool kit containing the software is then loaded on to the development machine, which is used for development of runtime images, which are transferred to a master flash disc. The said disc is transferred to a replicator machine. The replicator machine has the provision to copy the images from the master flash disc to any number of flash discs. Flash discs are then loaded on to the 'Thin Clients'. The license of the tool kit provides the appellant right to replicate the software on to the Thin Clients; but for sale of the Thin Clients containing the software, the appellant is required to affix the MS software licence (sticker labels) / COA, which are imported. The said stickers are initially purchased by one M/s. Priya Limited from M/s. Daymount Limited, UK. M/s. Priya Limited in turn sold the stickers / labels to the appellant on HSS basis, which were cleared by the appellant by filing necessary Bills of Entry declaring "MS software licence (sticker label)(Windows XP Embedded)" falling under Chapter heading No.4907 00 30 of the Customs Tariff Act and availed benefit under Sl.No.157 of the Notification No.21/2002 dated 01.03.2002 at 'nil' rate of duty.

8. The Revenue's contention is that the MS Windows Embedded 2009 Tool Kit purchased locally and loaded into Thin Clients manufactured by the appellant necessarily to be affixed with COA as per the agreement dated 11.01.2007; hence the stickers/labels which are imported/purchased on HSS basis are not 'goods' but 'service' falling under the taxable category of ITSS during the relevant period.

9. The contention of the appellant on the other hand is that stickers / labels imported by them is in the nature of 'goods' being affixed to the 'Thin Clients' before sale to identify and authenticate the software,

assessed by Customs authorities under CTH 4907 00 30 "documents of title conveying right to use Information Technology Software" and mere right to use the software in absence of transfer of Copy right use, therefore, is not a 'service' but 'sale' and accordingly cannot be leviable to service tax under ITSS as defined under Section 65(105)(zzzze)(v).

10. Before analysing the arguments, it is relevant to reproduce the definition of Information Technology Software as defined under Section 65(53a) and the taxable service Information Technology Software Service (ITSS) as defined under Section 65(105)(zzzze) of Finance Act, which read as follows:-

Section 65(53a): *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 a computer or an automatic data processing machine or any other device or equipment;*

Section 65 (105) (zzzze): *, Information Technology Software Service means any service provided or to be provided to any person, by any other person in relation to information technology software, 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) providing the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and the right to use*

software components for the creation of and inclusion in other information technology software products.

(vi) providing the right to use information technology software supplied electronically;

11. After introduction of service tax on Information Technology Software Service (ITSS) w.e.f. 16.05.2008, comprehensive Circular was later issued by the Board on 04.11.2009 explaining the distinction between sale of software and software service. It is relevant to reproduce the said instruction / circular.

4.1 INFORMATION TECHNOLOGY SOFTWARE SERVICE:

4.1.1 Information Technology (IT) software service includes,-

- Development (study, analysis, design and programming) of software.*
- Adaptation, up-gradation, enhancement, implementation and other similar services in relation to IT software.*
- Provision of advice and assistance on matters related to IT software, including:*
 - o Conducting feasibility studies on the implementation of a system,*
 - o Providing specifications for a database design,*
 - o Providing guidance and assistance during the start-up phase of a new system,*
 - o Providing specifications to secure a database,*
 - o Providing advice on proprietary IT software.*
- Acquiring the right to use,-*
 - o IT software for commercial exploitation including right to reproduce, distribute and sell,*
 - o software components for the creation of and inclusion in other IT software products,*
 - o IT software supplied electronically.*

*4.1.2 **Software** consists of carrier medium such as CD, Floppy and coded data. Softwares are categorized as "normal software" and "specific software". Normalised software is mass market product generally available in packaged form off the shelf in retail outlets.*

Specific software is tailored to the specific requirement of the customer and is known as customized software.

*4.1.3 **Packaged software** sold off the shelf, being treated as goods, is leviable to excise duty @ 8%. In this budget, it has been increased from 8% to 12% vide notification No. 12/2008-CE dated 01.03.2008. Number of IT services and IT enabled services (ITeS) are already leviable to service tax under various taxable services:*

- Consulting engineer's service - advice, consultancy or technical assistance in the discipline of hardware engineering [section 65(105)(g)].*
- Management or business consultant's service - procurement and management of information technology resources [section 65(65)].*
- Management, maintenance or repair service - maintenance of software, both packaged and customized and hardware [section 65(64)].*
- Banking and other financial services - 'provision and transfer of information and data processing' [section 65(12)].*
- Business support service - various outsourced IT and IT enabled services [section 65(105)(zzzq)].*
- Business auxiliary service - services provided on behalf of the client such as call centres [section 65(19)].*

*4.1.4 **IT software services** provided for use in business or commerce are covered under the scope of the proposed service. Said services provided for use, other than in business or commerce, such as services provided to individuals for personal use, continue to be outside the scope of service tax levy. Service tax paid shall be available as input credit under Cenvat credit Scheme.*

*4.1.5 **Software and upgrades of software** are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service.*

4.1.6 With the proposed levy on IT software services, information technology related services will get covered comprehensively.

4.1.7 Following consequential amendments in other taxable services are also being made:

- At present, 'Information technology service' is specifically excluded from the scope of Business auxiliary service [section 65(105)(zzb)]. Consequent on the proposed IT software service, information technology services get covered comprehensively for the purpose of levy of service tax and, therefore, specific exclusion of 'Information technology service' under Business auxiliary service is being deleted.*
- To include 'testing and analysis of IT software' services under Technical testing and analysis service [section 65(105)(zzh)].*
- To include 'Certification of IT software' services under Technical inspection and certification service [section 65(105)(zzi)].*
- To clarify as removal of doubts that 'Management, maintenance or repair of properties' includes Management, maintenance or repair of IT software [section 65(105)(zzg)]. Maintenance of packaged software (being goods) is also leviable to service tax under the said service.*
- Services provided in relation to advice, consultancy and assistance on matters related to IT software shall be leviable to service tax under the IT software service. Consulting engineer's service [section 65(105)(g)] in the discipline of computer hardware engineering is leviable to service tax whereas consulting engineer's service in the discipline of computer software engineering is not leviable to service tax by way of specific exclusion. Specific exclusion of 'consultancy in the discipline of computer software engineering' from the scope of 'consulting engineer's service' is not necessary and, therefore, being deleted.*
- To clarify that a consultancy service, covering both hardware and software consultancy, shall be classifiable under 'Consulting engineer's service'.*

12. The crux of the dispute in the present case centers around the fact whether the purchase/import of COAs/stickers / labels will result in sale

or service. The Circular dated 04.11.2009 throws light on the said question. It is reproduced as below:

*Government of India
Ministry of Finance (Department of Revenue)
Central Board of Excise & Customs, New Delhi*

*Subject: Applicability of indirect taxes on packaged software -
Regarding.*

The undersigned is directed to state that 'Packaged Software' is a type of IT software which caters to the needs of a variety of users and is capable of being used for variety of hardwares. IT software is fully exempt from basic customs duty being covered under Information Technology Agreement. So far as excise duty/CVD is concerned, while customised software is fully exempt, the packaged software attracts duty @ 8%.

2. Shrink wrap software is a type of packaged software which consists of a box containing software or software upgrade on media (i.e. CD/DVD), users manual and end-user licence agreements, which is shrink wrapped in plastic cover and is always sold as a set (without removing the plastic cover).

3. Normally, cost of a software supplied in a media consists of two cost components, namely, -

a. the cost of the actual software, i.e. set of information which is placed on a media; and

b. the cost of the Intellectual Property Right (IPR) relating thereto.

4. In 2008 budget, the IPR portion of the cost of software was brought under the service tax net under a new taxable service 'IT Software Service' (ITSS). As per the definition, a service provided in relation to IT software for use in the course, or furtherance, of business or commerce was covered under this taxable service. In specifics, the taxable service included, -

.....

(v) *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,*

(vi) *providing the right to use information technology software supplied electronically and the term 'service provider' shall be construed accordingly.*

5. *In their pre-budget representations for the 2009 budget, the IT companies and their associations represented that if such IT software is imported, it is likely to be subjected to double taxation. While for calculating additional duty, the value of 'right to use' supplied alongwith the software would be included (as per the provisions of the Customs Valuation Rules) by the Customs authorities, the service tax authorities would charge service tax on the same value (i.e. on right to use) considering it to be import of ITSS.*

6. *Accepting their plea, in Budget 2009, two parallel notifications were issued on the excise and customs side. Vide notification no. 22/2009-C.E., dated 7-7-2009, partial exemption from excise duty was provided to packaged or canned software on that portion of the value which represents the consideration for the transfer of the right to use for commercial exploitation, as on this portion, service tax would be leviable under the ITSS. Similar exemption from CVD was provided vide notification No. 80/2009-Customs dated 7-7-2009 on such software. These exemptions were notified to ensure that while importing or manufacturing packaged software, the importer/manufacture is spared from paying customs duty/excise duty on the value attributable to transfer of 'right to use'.*

7. *It has been brought to the notice of the Board that some of the importers of shrink wrapped software have faced certain difficulties in availing of Notification No. 80/2009-Customs dated 7-7-2009. It has been reported that their live consignments are held up, especially at Mumbai and Chennai cargo complexes. From the documents submitted by them it appears that two major objections have been raised at Mumbai and Chennai respectively.*

8. *It may be recalled that the first proviso of the said notification states that the exemption would be limited to that much of value which is towards right to use such software for commercial exploitation including the right to reproduce, distribute and sell such software and the right to use software components for creation of and inclusion in other information technology software products. In Mumbai, a view has been taken that the benefit of the notification is available only if all the activities, viz., right to reproduce, right to distribute, right to sell and right to use the software component for creation of and inclusion in other IT software products are fulfilled. Thus a conjunctive meaning of the term 'and' has been taken and it has been held that since the importer did not fulfill all the conditions, they should be denied the benefit of the notification.*

9. *In another case in Chennai, where fully packed product (FPP) was imported by a company which produced split value (i.e., one value for media CVD and other for right to use software) in a single invoice shown separately, the jurisdictional authorities have refused to accept such split value for the purpose of claiming notification No. 80/2009-Customs and taken the view that CVD should be charged on entire amount.*

10. *The above instances show that the field formations have failed to appreciate the scope of the said notification. In the first case, the view taken by officers is legally untenable because the phrase used in notification No. 80/2009-Cus is inclusive in nature and it is a well-known principle that in an inclusive expression, the word 'and' is to be understood as 'or' and that even if one of the activities (such as right to reproduce, right to distribute, right to sell etc.) mentioned in the said inclusive portion is carried out, it would satisfy the condition of commercial exploitation, thus making the import eligible for notification No. 80/2009-Customs. As for the second case, the notification No. 80/2009-Cus itself envisages splitting of the value of the imported goods into that pertaining to software on media and the one pertaining to right to use. In such cases, there is no rationale for the department to deny splitting of*

value unless there are reasons to believe that such a splitting has been done in order to evade payment of duty.

11. The assessment of the shrin wrapped packaged software may be done keeping in view the above directions.

12. This issues with the approval of the Member (Budget & ST).

13. After introduction of the ITSS, the vires of the same was challenged before the Hon'ble Madras High Court in the case of ***Infotech Software Dealers Association Vs. UOI and others*** [2010(8) TMI 13 – High Court of Madras]. While upholding the constitutional vires of the levy of service tax under ITSS, their Lordships held 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. In other words, it is the transaction between the parties is the decisive factor in determining whether the same is a sale or a service.

15. The Learned Commissioner in confirming the transaction of procurement/purchase Stickers/Labels as service recorded at para 85 of the impugned Order as follows:

"I find from the records placed before me that, the assessee is a manufacturer of thin client devices and terminals. Most of their thin clients or terminals are loaded with the Microsoft Operating System. The assessee procures/purchase the tool kit for loading the Microsoft software from the local dealers. The software of Microsoft is loaded onto the thin clients using the toolkit, for example, Windows embedded standard toolkit, the tool is in store in the development machine in the factory and as and when they manufacture of the thin clients, the toolkit installed in the development machine is used for developing runtime images, these are loaded onto a master flash and transferred to other flash discs using replicators. Thus, from one toolkit, the runtime images are replicated into the hard disk of the thin clients and terminals. Prior

*to distribution and sale of the thin clients the certificate of authenticity (COA) which are procured at high seas as Microsoft software license (sticker label), which represents the runtime licence of the end-user product are affixed. The assessee's are procuring Certificate of Authenticity (COA) which are stickers/labels that are affixed to each of the thin client devices and terminals manufactured by them. These COA's basically certify that the thin client devices and terminals contain the original software/operating systems. I further, find from the sample invoice no. 0028040 dated 21.07.2009 that M/s Daymont Ltd., 1st Floor, Battle House, 1 East barnet Road, Herts EN4 8RR, U.K., has raised commercial invoices for sale of Microsoft Software license (Sticker Labels) (Windows XPE Embedded) 2000 pieces to M/s Priya Limited, C-23/TTC Industrial Estate, Thane Belapur road, Opp. HICO, Pawane Village, Turbhe, New Mumbai, India. The same are in turn sold in high – seas sales to M/s VXL Instruments Ltd., Bangalore as it can be seen from invoice no. HI 10000051 DATED 21.07.2009. **As per the license agreement with Microsoft, no thin client or terminals can be sold without the Microsoft software license (sticker label) or the , COA from their strategic partners, is claimed as an attempt by the assessee under sl. No. 157 of Customs notification No. 21/2002 dated 1.03.2002."***

(emphasis supplied)

16. The Ld. Commissioner on analysing the agreement arrived at the conclusion that since 'Thin Clients or terminals' cannot be sold without the MS software licence (stickers / labels or COA) and thus procurement of stickers/labels is a service and chargeable to tax.

17. In the above context, to examine the transaction between the parties, it is necessary to refer to the relevant clauses of the agreement dt. 11.01.2007 titled as:

"Microsoft OEM Customer License Agreement for Embedded Systems", between MS and the appellant".

Article-1 Definitions

"ALPs" or "Additional Licensing Provisions" means licensing terms and conditions for the Licensed Product on the "Additional Licensing Provisions" label affixed to the Licensed Product package. Courtesy copies of the ALPs are available for COMPANY review from MS Distributor. If there are conflicting or incompetent terms between the ALPs on the Licensed Product packaging and the courtesy text presented by MS Distributor, the former shall control.

APM Associated Product materials means documentation, external media containing software and/or, other tangible materials related to the Licensed products MS may designate from time to time as redistributable components of a Licensed Product. APM does not include COAs.

COA – Certificate of Authenticity means a non-removable sticker designated by MS as specific to the Licensed Product

Deliverables means the Licensed Product software, tools and utilities, APM, and other items identified by MS as Deliverables. Deliverables are used for reproducing, configuring, and/or installing MS Binaries as part of an image. An example of deliverable is OPK

"Embedded System" means COMPANY's computing system or device with an image that (i) is designed for and distributed with an Embedded personal computing device (such as a general purpose function server or a commercially viable substitute for one of these systems.

End user means licenses customers of Embedded systems

"Licensed Products" means the MS products currently licensed under this Agreement and the applicable ALPs. Licensed Products include MS Binaries, other software (including Supplemental Code). COAs and APM.

"MS Distributor" means an MS-authorized embedded distributor or Licensed Products. COMPANY shall acquire Deliverables, ALPs, APM and COAs from MS Distributors. MS may amend the list of MS Distributors from time to time.

OPK means OEM preinstallation kit.

Product keys means a key used to install MS products, product keys are located either on a flyer in the OPK or on the installation

CD of the Licensed Product itself. Company will enter the product key when it installs the MS product onto the Embedded system during testing and development. Not all licensed product have product keys.

Runtime key means a series of characters that services to identify the Licensed product. Runtime keys are included in the APM for a specific licensed product. The Runtime key is used during manufacturing of the Embedded systems.

Runtime License Envelope means the envelope acquired from an MS Distributor that contains the ALPs for the Licensed Product. A Runtime License Envelope may contain COAs.

Suppliers means MSCORP and other licensors or suppliers of Licensed Product or portions thereof.

LICENSE GRANTS AND LIMITATIONS

(a) MS grants to Company the following non-exclusive, limited, worldwide license rights:

i) To order and acquire Deliverables and COAs for licensed products from an MS Distributor

ii) To use Deliverables to reproduce MS Binaries as part of an Image, only on Company premises by Company employees or contractors, for installation on Embedded systems.

iii) to use Deliverables to install one copy of the MS Binaries as part of an image on the hard disk drive or in non-volatile solid-state memory of an Embedded system, only on Company premises, by company employees or contractors.

iv) To Distribute Embedded Systems containing an Image if (A) a COA is affixed to ES in accordance with this Agreement and (ii) Company sublicenses such image to an End user by means of License Terms. Company must acquire Runtime License Envelope from an MS Distributor for the Licensed Product to distribute an ES with that LP.

v) To distribute update images and recovery images to end users in accordance with the terms and conditions.

h) Unless a COA is not required, company shall permanently affix the applicable COA for each LP to an accessible location on each Embedded System. If this is not physically possible, company shall attach the COA to the APM. Company shall also distribute the APM, if any, with each Embedded System.

(m) Not a Stand Alone product: Company shall not advertise, provide a separate price for, or otherwise market or distribute the Licensed products or any images as a separate item from the Embedded system.

(s) No Representations for MS: Company shall not make any representation or warranty (express or implied) to End Users or any other third party on behalf of MS.

18. On a cumulative reading of the definitions and the 'Licence Grants and Limitations' in the present context, we find that the appellant are engaged in the manufacture of 'Thin Clients', which required a software to make it functional/operational and they are not distributors/resellers of the installed/ embedded software. For the said purpose, to acquire the necessary software to be embedded with the system, they entered into an agreement with MS, whereby they were authorized to procure off-shelf MS OS software, which also provided them the right to replicate into individual hard discs installed later into the Thin Clients. The software would be operational or functional only with affixation of the stickers i.e. COAs procured separately for each of the Thin Clients from the authorized MS distributors. Clause 'm' of the 'Licence Grants and Limitations' makes it clear that the appellant shall not advertise, provide a separate price for, or otherwise market or distribute the Licensed products or any images as a separate item from the Embedded system.

19. The appellant procured / purchased the stickers/labels on HSS basis from M/s. Priya Limited. The imported stickers/labels are considered as 'goods' more or less in line with the Circular No.15/2011 dated 18.03.2011 issued by the Board. The said circular reads as follows:-

*Government of India
Ministry of Finance (Department of Revenue)
Central Board of Excise & Customs, New Delhi*

*Subject: Applicability of indirect taxes on packaged software -
Regarding.*

Representations have been received from some industry association on behalf of software dealers about difficulties being expressed in the assessment to customs duty of documents of title for IT software or documents that enable the transfer of the right to use such software at the time of its sale. It has been reported that there are frequent imports of such documents without any accompanying software. Such packages do not contain software but consist of paper licenses or PUK (Personal Unlocking Key, usually in the form of a scratch card of paper board or plastic) that are used to convey the right to use such IT software. The software in these cases could be freely downloadable or loaded by the OEM supplier under an arrangement with the software company as pre-loaded trial version of software on the computer system requiring the customer to purchase license or PUK after the trial period. Typically these licenses are used either to authorize additional uses against a sale of IT software that has already taken place in the past or to service transactions where the connected software is downloaded electronically by the customer. It has been pointed out that some of the field formations are insisting on the classification of such documents, even when imported without the packaged software, under CTH 8523 i.e. the heading applicable to IT software. It has also been represented that in certain cases the

entire value of the license representing the right to use such IT software is sought to be loaded to the value of past imports of IT software by the importer.

2. The issue has been examined. According to Rule 1 of the Rules for the interpretation of the Tariff Schedule, classification is to be determined according to the terms of the heading and any relative Section or Chapter Notes. Heading No. 85.23 refers to "Discs, Tapes, Solid-State Non-Volatile Storage Devices, "Smart Cards" and other Media for the recording of Sound or of other phenomena, whether or not recorded, including Matrices and Masters for the production of Discs, but excluding products of Chapter 37." Tariff item 8523 80 20 of this heading covers "Information Technology software." The supplementary note to Chapter 85 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. It is evident that document conveying the right to use software by themselves do not satisfy this definition and therefore do not qualify for classification under this tariff item because they do not contain any representation of instructions, data, sound or image recorded in a machine readable form, which is capable of being manipulated or providing interactivity to a user. On the other hand, tariff item 49070030 of heading 4907 refers directly to "Documents of title conveying the right to use Information Technology software". Hence as per the said Rule 1 mentioned above, such paper licenses which are essentially documents conveying the right to use such IT software, merit classification under CTH 49070030. PUK cards on the other hand are not documents of title conveying the right to use Information Technology software per se but are actually printed matter containing numbers which when entered, enable the importer to access right to use such IT software. Hence they are liable to classified under CTH 4911 as "other printed matter".

3. *It is, therefore, clarified that paper licenses or PUKs merit classification as per their individual character under heading 4907 in case of paper license and heading 4911 in case of PUK card, the same being other printed matter.*

4. *In the context of assessment of pre-packaged software imports, kind attention is also drawn to Notification No. 30/2010-Central Excise (N.T.) dated 21st December, 2010 by which all such packaged software or canned software were brought under the purview of assessment based on retail sale price, as also Notification No. 25/2011-Cus., dated 1-3-11 and Notification No. 14/2011-C.E., dated 1-3-11, whereby in case of such packaged software which does not require affixation of Retail Sale Price (RSP), exemption has been provided, from payment of Excise duty/CVD, on the portion of value representing consideration for transfer of right to use such packaged/canned software. These exemptions have been issued in order to rule out taxation of this portion of the value twice-once as Excise duty/Additional duty of Customs and another time as Service Tax on the consideration that all package software is not sold as shrink wrapped software and that affixation of retail sale price is not required for certain categories viz. (i) software on optical media supplied free of charge, for which right to use or license is purchased separately; (ii) full pack -packaged software with limited validity, not for resale and generally imported for demonstrations or for OEMs; (iii) up-grade full pack-packaged software-supplied free of charge under annual maintenance/subscription/software assurance contract; and (iv) up-dates for packaged software-supplied free of charge under annual maintenance/subscription/software assurance contract etc.*

5. *Accordingly, **all packaged/canned software imported in shrink wrapped packages, will attract Excise duty/CVD on such retail sale price declared** being the combined value of the software and the licenses (right to use). **Such software will, however, be exempt from payment of service tax under the category ITSS** (as provided in Notification No. 53/2010-S.T.*

*dated 21st December 2010). On the other hand, **such packaged/canned software, on which affixation of retail sale price is not required** under the relevant provisions for the packaged commodities, and the assessment is based therefore, on the value determined under section 4 of the Central Excise Act, 1944, the **excise duty/CVD will be charged only on the value, excluding the value representing consideration for transfer of right to use such packaged/canned software. However, service tax under the category ITSS would be levied on such portion subsequently.***

6. All pending assessments of software, paper licenses and PUK cards may be finalized accordingly. These instructions may also be brought to the knowledge of the field formations and the trade. Any difficulty faced in implementation of these instructions may be brought to the attention of the Board.

Following, the Circular, the Customs Department has assessed the stickers/labels under CTH 4907 00 30 of Schedule to the Customs Tariff Act, 1975.

20. Thus, merely by affixing the stickers / labels providing authenticity to software loaded to each of the Thin Clients cannot be construed as a 'service' received by the appellant under the category of ITSS as held by the Commissioner in the impugned order. We are of the view, in the absence of a transfer of copyright of the software but only on mere right to use the software as clarified in the aforesaid circulars in explaining the scope of the levy as 'service' under ITSS, distinguishing the same from levy of excise duty and applicable customs duty being Information Technology software falling under Chapter 85 of Central Excise Tariff Act, 1985 or CTA, 1985 as the case may be, the import of stickers/labels, later affixed to the Thin clients cannot be considered as a 'service' and attract levy under ITSS.

21. The judgments cited by the learned AR for the Revenue, in our opinion are not applicable to the facts of the present case inasmuch as in those cases, the facts revolved around distribution/sale of the software by the authorised distributors and not sale of embedded system loaded on 'Thin Client' without transfer of copyrights. Therefore, we find merit in the contention of the learned senior advocate for the appellant that the whole transaction/activity including the installation of the software and later affixing stickers / labels to the Thin Clients procured / purchased on HSS basis from M/s. Priya Limited are in the nature of 'sale' and not service. Consequently, demand of service tax on reverse charge basis on the Appellant cannot be sustained.

22. Regarding the issue of limitation, we find that the stickers / labels have been imported by the appellant by filing relevant Bills of Entry from time to time and the said stickers/labels are assessed as 'goods' by the Customs department, which are later warehoused as per the procedure under the Customs Act and the Rules made thereunder. In these circumstances, allegation of suppression of facts cannot be sustained.

23. In the result, the appeal succeeds both on merit as well as on limitation.

(Order pronounced in open court on 06.03.2024)

(D.M. Misra)
Member (Judicial)

(Pullela Nageswara Rao)
Member (Technical)

Raja...