

TATA CONSULTANCY SERVICES

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v.

STATE OF ANDHRA PRADESH

MARCH 13, 2001

[S. RAJENDRA BABU AND R.C. LAHOTI, JJ.]

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*Sales Tax :*

*Andhra Pradesh General Sales Tax Act, 1957 : Section 2(h).*

*Goods—Computer software—Sales Tax—Levy of—Whether development of customised computer software programmes for a customer do not constitute computer and data processing services because the true object of software development contract was not to obtain the services of the consultant, but to obtain software programmes consisting of intangible intellectual property which are not taxable—In view of the importance of the matter having global implications, referred to a larger Bench.*

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The High Court held that the computer software which were standardised and marketed for the use of certain classes of clients, like the Oracle, Lotus, Master Key, N-Export, Ex-Unigraphics etc. were goods under Section 2(h) of the Andhra Pradesh General Sales Tax Act, 1957 and liable to sales tax. Hence this appeal.

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Disposing of the appeal, the Court

**HELD : 1.** In the instant case, the question raised is whether development of customised computer software programmes for a customer do not constitute computer and data processing services because the true object of software development contract is not to obtain the services of the consultant, but to obtain software programmes consisting of intangible intellectual property which are not taxable. [363-E]

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**2.** In view of the importance of the matter having global implications it is referred to a larger Bench. [364-E]

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*PSI Data Systems Ltd. v. CCE, [1997] 2 SCC 78; Associated Cement Co. Ltd. v. Commissioner of Customs, JT (2001) 2 SC 141; Wal-Mart Stores, Inc. v. City of Mobile & County of Mobile, 200-622, Supreme Court of Alabama (1996), Advent Systems Ltd. v. UNISYS Corpn., 935 F 2d 670*

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- A (3d Cir 1991); *Beta Computers (Europe) Ltd. v. Abode Systems (Europe) Ltd.*, (1995); *Commerce Union Bank v. Tidwel*, 56-85 TN-Taxrptr-TB 200-279; *Tennessee Supreme Court, State of Alabama v. Central Computer Services Inc.*, 379 Se 2nd 1156; *BOB Bullock, Comptroller v. Statistical Tabulating Corpn.*, 60-82 Tx-Taxrptr-TB 200-683 *Texas Supreme Court, The First National Bank of Fort Worth, A National Banking Association v. BOB Bullock Comptroller of Public Accounts, State of Texas*, 548 sw 2nd 548;
- B *First National Bank of Springfield v. Department of Revenue*, 55-84 II-Taxrptr-TB 201-165; *Illinois Supreme Court, Ray S. James, Director of Revenue, State of Missouri v. Tres Computer Systems inc.*, 642 SW 2nd 347; *Comptroller of the Treasury v. Equitable Trust Co.*, 296 Md. 459, 464 A.
- C 2nd 248; *Chittenden Trust Co. v. Commissioner of Taxes*, 55-98 VT-Taxrptr-TB 200-193; *Vermont Supreme Court, Toby Constructions Products Pty. Ltd. v. Computa Bar (Sales) Pty. Ltd.*, (1983); *University Computing Co. v. Hon. Martha Olsen, Commissioner of Revenue for the State of Tennessee*, 677 SW 2d 445; *Hasbro Industries, inc. v. John H. Norbery, Tax Administrator*, 487 A. 2d. 124; *Compuserve, inc. v. Lindley*, 535 NE 2nd 360; *Northeast Datacom, inc. v. City of Wallingford*, 55-90 CT-Taxrptr-TB 200-320; *Connecticut Supreme Court, South Central Bell Telephone Co. v. Sindney K. Barthelemy*, 643 So. 2d 1240; *Kenneth P. Hahn, As Assessor, Etc. v. State Board of Equalization, State v. Central Computer Services, Inc.* (1977, Ala) 349 Sc. 2d 1160, 61 ALR 3d 274 and *Andersen Consulting, LLP v. Gene Gavin, Commissioner of Revenue Services*, (2000) Connecticut Superior Court, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2582 of 1998.

- F From the Judgment and Order dated 12.12.96 of the Andhra Pradesh High Court in T.R.C. No. 99 of 1996.

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Civil Appeal Nos. 2583, 2584, 2585 and 2586 of 1998.

- G G.S. Jetly, Pradeep Jetly, A.S. Bhasme and Manoj Kumar Mishra for the Appellants.

K. Ramkumar, B. Sridhar, Ms. Shantinarayana and Y. Subba Rao for the Respondent.

- H The Judgment of the Court was delivered by

**RAJENDRA BABU, J.** In these matters the Andhra Pradesh High Court concluded that software is of two categories - (i) software which is specialised and exclusively custom-made to cater to the needs of individual clients, and (ii) software which is standardised and marketed for the use of certain classes of clients, like the Oracle, Lotus, Master Key, N-Export, Ex. Unigraphics, etc. and held that for the purpose of the Andhra Pradesh General Sales Tax Act (hereinafter referred to as 'the Act') it is not necessary to consider whether the definition of 'goods' in Section 2(h) of the Act has to be read down so as to exclude software from it. The High Court took the view that the first category may not constitute 'goods' for the purpose of the Act, while the second category are 'goods' and held that they are leviable to tax.

The case advanced on behalf of the appellants is that the branded software which is an intellectual property being product of thought, creativity and intellectual efforts cannot be 'goods' for the purpose of the Act; that it is an intangible intellectual property and, therefore, cannot be goods; that software is an essentially classic form of intellectual property; that the value of the tapes on which it is sold is much lesser than the value of the software programme itself; that the software programme is always transferred onto the hardware and then the tapes are useless; that, therefore, the licensee/payer is paying for the programme and not for the tapes or discs; these discs are different from music cassettes and video tapes, music reels, etc. because the programme on the discs is separable and is always transferred to the hardware, whereas in the case of music cassettes, etc. though they may be separable and can be transferred to another cassette or tape this is not generally done and the music or movie always remains on the tangible property on which it was stored when sold; that there are other methods by which a software programme can be installed, like, the programme directly keying in the programme through the console keyboard; that what is transferred is the right to use the programme (which is a set of instructions) and not the tape on which it is stored; that though software has a physical component, these physical components are merely tangential incidents of a computer programme, they do not change the programme's clearly intangible character; that the essence of the contract is the right to use the software, therefore, the essence of the transaction test must be applied; that in *PSI Data Systems Ltd. v. Collector of Central Excise*, [1997] 2 SCC 78, it is held that if discs, floppies, CD ROMs are sold along with the computer, their value is not to be included for assessing excise duty; that a software programme

A is a process that can be used to achieve a certain result whereas a music cassette etc. is the end product in itself.

B While on behalf of the respondents the case of the appellants is resisted on the ground that the magnetic tapes, discs, are necessary to carry the programme and for the transfer to the hardware and, therefore, the value of the tapes is equal to the value of the programme; that the fact that the programme can be transmitted through some other means does not take away from the fact that in fact a tangible means was actually used; that music cassettes, phonographs and movie tapes are indistinguishable from discs and tapes because (i) they can also be transmitted by telephone lines and through radio waves, and (ii) the contents of music cassettes etc. are also transferable to some other medium belonging to the purchaser of the right to use; that software is tangible property and software recorded in physical form becomes inextricably linked with the corporeal object upon which it is stored, that is, a disc, tape, hard drive, etc.; that the fact that the information can be transferred and then physically recorded in another medium does not make software any different from any other type of recorded information that can be transferred to another medium such as film, videotape, audio tape or books; that the distinction between books, films, videotapes, audio-tapes etc. on the one hand and computer programme on the other on the basis that the former cannot exist without the tangible medium and the latter can be unsustainable because even a programme has to be stored on some medium like the hard disc and books, music etc. can also be transferred from one medium to another; that in *Wal-Mart Stores, Inc. v. City of Mobile & County of Mobile*, 200-622, Supreme Court of Alabama (1996), the Court said, "Software is an arrangement of matter recorded in a tangible medium and, therefore, constitutes a corporeal body"; that whether another medium was actually used should be seen.

G This Court in *M/s Associated Cement Companies Ltd. v. Commissioner of Customs*, JT (2001) 2 SC 141, examined a similar question in the context of the Customs Act and Tariff Act with reference to the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 wherein several decisions rendered relating to levy of sales tax in the context of works contract were cited to contend that the drawings, plan, manuals, etc. supplied were in the nature of intellectual property being knowledge or know how which could only amount to service and not goods. This Court is of the view that those decisions would not be of any help in the case in which the matter

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was being considered as the question before them was only whether the papers or diskettes etc. containing advice and/or information are goods for the purpose of the Customs/Tariff Act. In the course of the discussion several observations have been made as to the nature of the goods and the expression 'goods' used in various contexts is also taken note of in arriving at the conclusion. It is specifically stated that once these drawings, etc. were put on the diskettes it would enhance the value of those goods and adopted the reasoning set out in *Advent Systems Limited v. UNISYS Corporation*, [925 F 2d 670 (3d Cir 1991)] that computer programmes are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners though the programme can be copyrightable as intellectual property it does not alter the fact that once in the form of a floppy disk or other medium the programme is tangible, moveable and available in the market place and, therefore, would amount to 'goods'. The fact that some programmes may be tailored for specific purposes need not alter their status as 'goods'. To arrive at these conclusions this Court referred to several decisions cited therein.

The debate adverted to by us as to development of customised computer software programmes for a customer do not constitute computer and data processing services because the true object of software development contract is not to obtain the services of the consultant, but to obtain software programmes consisting of intangible intellectual property which are not taxable. The services used to customise and develop the computer software are part of the final software package sold and not separate computer and data processing services subject to tax.

This debate will be incomplete without considering the decisions in addition to those cited in *Associated Cement Company Ltd.* case [supra] and those referred to in this order, to the following: *Beta Computers (Europe) Ltd. v. Abohe Systems (Europe) Ltd.*, (1995); *Commerce Union Bank v. Tidwell*, 56-85 TN-Taxrptr-TB 200-279 Tennessee Supreme Court; *State of Alabama v. Central Computer Services, INC*, 379 So 2nd 1156; *BOB Bullock, Comptroller v. Statistical Tabulating Corporation*, 60-82 Tx-Taxrptr-TB 200-683 Texas Supreme Court; *The First National Bank of Fort Worth, A National Banking Association v. BOB Bullock Comptroller of Public Accounts, State of Texas*, 584 sw 2nd 548; *First National Bank of Springfield v. Department of Revenue*, 55-84 IL-Taxrptr-TB 201-165 Illionis Supreme Court; *Ray S. James, Director of Revenue, State of Missouri v. Tres Computer Systems*,

- A *INC.*, 642S.W. 2nd 347; *Comptroller of the Treasury v. Equitable Trust Co.*, 296 Md. 459, 464 A.2nd 248; *Chittenden Trust Co. v. Commissioner of Taxes*, 55-98 VT-Taxrptr- TB-200-193, Vermont Supreme Court; *Toby Constructions Products Pty. Ltd. v. Computa Bar (Sales) Pty. Ltd.*, (1983); *University Computing Company v. Hon. Martha Olsen, Commissioner of Revenue for the State of Tennessee*, 677 S.W. 2d 445; *Hasbro Industries, INC. v. John H. Norberg, Tax Administrator*, 487 A.2d 124; *Compuserve, INC. v. Lindley*, 535 N.E. 2nd 360; *Northeast Datacom, INC v. City of Wallingford*, 55-90 CT-Taxrptr-TB 200-320, Connecticut Supreme Court; *South Central Bell Telephone Co. v. Sindney K. Barthelemy*, 643 So.2d 1240; *Wal-Mart Stores, INC. v. City of Mobile & County of Mobile (supra)*; *Kenneth P. Hahn. As Assessor, etc. v. State Board of Equalization*; *State v. Central Computer Services. Inc.*, (1977) Ala 349 So. 2d 1160, 91 ALR 3d 274); and *Andersen Consulting, LLP v. Gene Gavin, Commissioner of Revenue Services*, (2000) Connecticut Superior Court.
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D Deeper and further consideration is required in view of the importance of the matter having global implications. Therefore, an authoritative pronouncement is required on all these aspects of the matter. In that view of the matter, we think it appropriate to place the papers in these cases before the Hon'ble the Chief Justice of India to be referred to a Larger Bench.

E V.S.S.

\* Appeals disposed of.