No service tax on software updates provided before it was introduced on IT services – CESTAT

5 September 2024

Summary

The CESTAT Bangalore has held that the software updates, invoiced, and paid before introducing service tax on Information Technology Software Services (ITSS), cannot be taxed retrospectively. The Tribunal further held that even if the service period is extended beyond the introduction date, these cannot be taxed pro-rata by bifurcating the value. Additionally, the Tribunal rejected the Revenue's claim of suppressing facts by the appellant and set aside the impugned order. The case was remanded back to the original authority for reconsideration of the refund claim.

Facts of the case

- M/s. Oracle India Pvt. Ltd. (the appellant) is a wholly owned subsidiary of M/s. Oracle Systems Corporation, USA, engaged in the distribution, promotion, marketing, licensing, and sub-licensing of the software products developed by Oracle USA.
- The appellant had provided software update services to clients under contractual agreements. The contracts included granting clients the right to use software updates, with payments made upfront for the entire contract term, which typically spanned a year or more.
- Before 16 May 2008, the appellant did not pay service tax on these contracts, as the Information Technology Software Service (ITSS) was not taxable under Chapter V of the Finance Act, 1994 (service tax law).
- However, with effect from 16 May 2008, the ITSS became taxable.
- The department alleged that where services were continued to be provided even after 16 May 2008, that part of the value of services offered or provided on or after 16 May 2008 is liable for the payment of service tax on a pro-rata basis.
- Therefore, a show cause notice was issued for 2008-09 and 2009-2010, demanding service tax, which was confirmed along with interest and penalty. Therefore, the appellant filed an appeal before the CESTAT Bangalore.

Issues raised before CESTAT

- Is service tax applicable to software updates under contracts entered into before 16 May 2008, for services rendered after the date?
- Should the value of services provided or those to be provided post 16 May 2008, under these pre-existing contracts, be taxed on a pro-rata basis?

Petitioner's contention

- The appellant submitted that since the contracts, invoicing, and payments were completed before 16 May 2008, service tax cannot be imposed on these transactions as the ITSS was not taxable at that time.

- It contended that the division of a single transaction into pre-tax and post-tax periods is illegal and unsupported by statutory provisions.
- The appellant argued that taxing the same services under different heads (Business Auxiliary Services for the period 2004-2009 and the ITSS for the period after 16 May 2008) constitutes double taxation, which is impermissible.
- The appellant claimed that the entire demand is time-barred, as the SCN was issued beyond the regular limitation period and only after they filed for a refund of service tax and interest paid under protest.

CESTAT's observations and judgement [Service Tax Appeal No. 3061 of 2011, order dated 8 August 2024]

- **Service tax cannot be levied for the period before 16 May 2008:** The CESTAT observed that the agreement was signed on 1 June 2003, all the invoices on 'software updates' were admittedly issued, and payments were made before 16 May 2008. Therefore, because the validity of the software updates is for a calendar year and part of the period falls after 16 May 2008, there cannot be a service tax levy as per the law's provisions.
- **Pro-rata basis taxation not in accordance with law:** The CESTAT noted that the entire consideration for services was received before 16 May 2008. Therefore, service tax shall not be payable for the part or whole of the value of the services that is attributed to the services provided during the period when such services were not taxable. It further held that bifurcating the value on a pro-rata basis is not in accordance with the law.
- **Other judicial precedence:** The Tribunal referred to the SC's ruling in the case of M/s. S. R. Traders and observed that in that case, though the agreements were entered into before 1 April 2016, the payments were received after April 2016. Hence, the appellant would be liable to pay service tax. In contrast, in the present case, all the events occurred before 16 May 2008.
- **Appeal allowed:** The Tribunal allowed the appeal and set aside the earlier orders. The refund claim was remanded to the original authority for reconsideration, with instructions to hear the appellant's case afresh.

Our comments

In the case of the Bajaj Alliance General Insurance Company Ltd, the Tribunal had held that service tax could not be levied on the contracts entered and where payments were made before the introduction of the levy of service tax on the ITSS. The SC upheld this ruling.

Further, in the case of Reliance Industries Ltd., the Tribunal held that service tax shall be payable on the rate prevailing on the date of service provision and not the rate prevailing at the time of billing and receipt of the payment. The Gujarat High Court further upheld this decision.

The above precedents are pivotal to the CESTAT's ruling, the basis on which it has set aside similar demands in the present case, reaffirming that tax cannot be levied for the period prior to the introduction of levy. The judgement shall provide relief to taxpayers who may have faced similar issues and shall set precedence in similar matters.

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