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Supply of antivirus software in compact disk (CD) amounts to a deemed sale and not leviable to service tax – Supreme Court (SC)

9 August 2022

Summary

The SC has upheld the New Delhi Customs Excise and Service Tax Appellate Tribunal's (CESTAT) view that the sales/supply of antivirus software in CD, under the brand name Quick Heal, to the end-users, by charging licence fee is a deemed sale and not leviable to service tax. The SC has held that it is one transaction of software sale put in the CD as 'goods' and thus, the transaction lacks any separate service element. The artificial segregation of the transaction into two parts is not tenable in law and even otherwise, the user is put in possession and full control of the software. The end-user licence agreement (EULA), giving the end customer the licence to use the software, is a transfer of right to use goods (i.e., the antivirus software) and is a 'deemed sale', as per Article366(29A)(d) of the Constitution.

Facts of the case

- The appellant[1] is engaged in the business of research and development of antivirus software under the brand name Quick Heal.
- The appellant contended that the software developed by third-parties[2] and sold in a ready to sell condition is a canned software, which is in nature of goods, hence was subjected to sales tax/value-added tax (VAT) and no service tax was payable on the same.
- The Adjudicating Authority (AA)[3] had issued a Show Cause Notice (SCN) to the appellant demanding service tax with an interest and a penalty, alleging that the supply of Quick Heal antivirus software replicated CDs/DVDs in retail packs with key/codes by charging licence fees through dealers/distributors amounts to provision of service. The end user was provided with a temporary/ non-exclusive right to use the antivirus software, as per the conditions contained in the EULA and would, therefore, not be treated as deemed sale[4].
- The AA passed an order confirming the demand and held that extended period was correctly invoked. Thus, the aggrieved appellant had filed the present appeal before New Delhi CESTAT, which was thereby allowed.
- The revenue filed a Special Leave Petition (SLP)[5] before the SC challenging the Tribunal's order.

CESTAT observations and ruling[6]

- **Antivirus software not covered under the definition of 'Information Technology (IT) software[7]':** The antivirus software is complete to prevent virus in the computer system. No interactivity takes place nor there is any requirement of giving any command to the software to perform its function of detecting and removing virus from the computer system. Therefore, the antivirus software developed by the

[1] Quick Heal Technologies Limited
[2] M/s Softtalk Technologies Limited, M/s Jupiter International Limited and M/s IP Softcom (India) Private Limited
[3] Additional Director General
[4] Under article 366(29A) of Constitution
[5] S.L.P. (CIVIL) NOS. 67156716 OF 2022
[6] Final Order No. 50022/2020 dated 9 January 2020
[7] As defined u/s 65(105)(zzzze) of the Finance Act, 1994 prior to 1 July 2012 and u/s 65B(28) of the Finance Act, 1994 after 1 July 2012

appellant is not covered under the definition of IT software, since it lacks the element of interactivity.

- **Supply of software in CD and other mediums is not a service:** The CESTAT relied on SC judgement in case of Tata Consultancy Service[8] and concluded that sale of canned software or pre-packaged software in CD is in nature of the sale of goods and therefore, no service tax is leviable. However, where there is no transfer of right to use[9], it would fall under the scope of service and not deemed sales.
- **Whether the right to use software is transferred to licencee:** The CESTAT, upon perusal of agreement of the appellant, observed that licencee have all the right to use the software from date of activation to expiry subject to terms and conditions**.** Merely because Quick Heal retains the title and ownership of the software, does not imply it interferes with the right of the licencee to use the software. Thus, it was concluded, that the right to use the software is given and it would be treated as deemed sales.

SC observations and ruling[10]

- **Criteria for transfer of right to use goods:** The levy of tax under Article 366(29A) (d) is not on the use of goods. It is on the transfer of the right to use goods, which accrues only on account of the transfer of the right. In other words, the right to use goods arises only on the transfer of such right to use goods. The transfer of right is the *sine qua non* for the right to use any goods and such transfer takes place when the contract is executed, under which the right is vested in the lessee.
- **Canned and un-canned software can be goods:** To determine whether a property is goods, the correct test would be to determine whether the item is capable of abstraction, consumption and use. Also, it is important to determine whether it can be transmitted, transferred, delivered, stored or possessed. Thus, both canned and un-canned software can be goods.
- **Sale of software in CD and sale of updates are not separate transaction:** Relying upon the decision in case of BSNL, the SC stated that the contract cannot be divided into two, i.e., sale of CD and supply of updates. Artificial segregation of the transaction into two parts is not tenable in law. It is, in substance, one transaction of sale of software and once it is accepted that the software put in the CD is goods, then there cannot be any separate service element in the transaction.
- **Deemed sale:** The user is put in possession and full control of the software. Therefore, the sale of software in CD amounts to deemed sales, which could not attract service tax.

[8]Trade Tax Revision No.1566 of 2006 dated 4th April 2019

[9]Sub-clause (d) of article 366(29A) of the Constitution

[10] Civil Appeal Nos. 5168-5169 of 2022 dated 5 August 2022

Our comments

This is an important ruling by the Apex Court and aligns with its earlier decision in case of Tata Consultancy Services, wherein it had held that canned software supplied in CDs would be 'goods' chargeable to sales tax/VAT and no service tax can be levied.

Even under the Income Tax laws[11], in respect of the EULA, the SC had clarified that a non-exclusive, non-transferable licence, merely enabling the use of a copyrighted product, is restrictive in nature. Such licence is an ancillary and cannot be construed as a licence to enjoy all or any of the enumerated rights mentioned in the Copyright Act. The SC concluded that what is 'licensed' and sold to the resident end-user is in fact the sale of a physical object, which contains an embedded computer programme, and is therefore, a sale of goods.

Under the GST law, the Central Board of Excise and Customs[12] has clarified that supply of pre-designed or pre-developed software, in any medium/storage or made available through use of encryption keys, shall be supply of goods[13]. Further, the 'explanatory notes to the Scheme for classification of services' provide that the services of limited end-user licence as part of packaged software are not covered under licensing services for the right to use computer software[14].

[11] Engineering Analysis Centre of Excellence (P) Ltd.
[12] vide its sectoral FAQ on IT and IT enabled services
[13] classifiable under heading 8523
[14] SAC 997331

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