A M/S. PSI DATA SYSTEMS LTD.

v.

COLLECTOR OF CENTRAL EXCISE

DECEMBER 17, 1996

B [S.P. BHARUCHA AND S.C. SEN, JJ.]

Central Excises and Salt Act, 1944: Section 5-A(1).

Excise duty—Notification dated 1.3.1989—Exemption to computer
C *software falling under heading 85.24.*

Central Excise Tariff Act, 1985: Schedule—Chapter 84 Headings 84.71 and 85.24—Note 5(a) and 6.

Excise duty—Valuation—Computer—Software such as discs, floppies,
D *CD-ROMs sold along with computer—Value of such software held not includible in assessable value of computers.*

The question in these appeals is whether the value of software, such as discs, floppies, CD ROMs and the like (not the intellectual property recorded or stored thereon), also called software, that is sold along with
E **the computer, was to be included in the assessable value of computers for the purposes of excise duty. The Customs, Excise and Gold (Control) Appellate Tribunal proceeded upon the basis that the appellant-assessee sold computer systems and that a computer system was incomplete without systems software inasmuch as mere hardware without systems software did not make the system workable. Accordingly it held that the**
F **excise liability of the computer system had to be determined with reference to the computer system itself and for assessment of the computer system it was immaterial whether the software was a bought out item. In the assessment of the computer system an individual part lost its independent identity and became a part of the computer system. Against the judgments**
G **and orders of the Tribunal appeals were filed before this Court.**

Allowing the appeals and setting aside the impugned judgments and orders, this Court

HELD : 1. In the first place, the Tribunal confused a computer
H **system with a computer; what was being charged to excise duty was the**

computer. Secondly, that a computer and its software are distinct and separate is clear, both as a matter of commercial parlance as also upon the material on record. A computer may not be capable of effective functioning unless loaded with software such as discs, floppies and C.D. ROMs, but that is not to say that these are part of the computer or to hold that, if they are sold along with the computer, their value must form part of the assessable value of the computer for the purposes of excise duty. Thus, the value of software, if sold along with the computer, cannot be included in the assessable value of the computer for the purposes of excise duty. [272-A-B]

Collector of Central Excise, Bangalore **v.** *Sunray Computers Pvt. Ltd.*, **(1988) 33 ELT 787, overruled.**

State of Uttar Pradesh **v.** *M/s. Kores (India) Ltd.*, **[1977] 1 SCR 837 and** *State of Mysore* **v.** *Kores (India) Ltd.*, **(1970) 26 S.T.C. 87 (Mys.), referred to.**

Robert P. Biglow, *Computer Contracts: Negotiating and Drafting Guide*, **referred to.**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 491 of 1989 Etc.

From the Judgment and Order dated 2.11.88 of the Customs, Excise & Gold (control) Appellate Tribunal, New Delhi in F. No. E.A. No. 2387/85-A with E-Cross 23 of 1986-A Final Order No. 543 of 1988-A.

Atul Setalvad and D.A. Dave, Ravinder Narain, Amit Bansal, Ashok Sagar, Sajan Narain, M.B. Gupta, and Amrita Mitra, for the Appellants.

J. Vellapally, Y.P. Mahajan, V.K. Verma, P. Parmeswaran, V. Lakshmikumaran, V. Saridharan and V. Balachandran for the Respondent.

The Judgment of the Court was delivered by

BHARUCHA, J. These appeals against the judgment and orders of the Customs, Excise and Gold (Control) Appellate Tribunal relate to the assessable value of computers for the purposes of excise duty. The appeals of M/s. Wipro Information Technology Limited (Civil Appeal No. 79 of 1989 and M/s. PSI Data Systems Limited (Civil Appeal No. 491 of 1989)

A relate to the tariff as it was prior to 28th. February, 1986. The appeal of M/s. Tata Unisys Limited (Civil Appeal No. 6042 of 1994) relates to the present tariff under the Central Excise Tariff Act, 1985.

The question, principally, is in relation to the inclusion of the value of software sold with the computer in the assessable value thereof. It is not B the contention of the appellants that the firm or etched software that is implanted into a computer is not to be taken into account in the valuation thereof for the purposes of excise duty. It is their case that the value of the software, such as discs, floppies, C.D. rhoms and the like, that they may sell along with the computer is not to be taken into account for the C aforesaid purpose.

We make it clear at the outset that when we shall speak of software, we shall be referring to tangible software of the nature of discs, floppies and C.D. rhoms and not to the intellectual property, also called software, that is recorded or stored thereon.

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It is necessary, to start with, to make a distinction between hardware, which is the computer, and the programming necessary to run it, which is the software. (See Computer Contracts Negotiating and Drafting Guide by Robert P. Bigelow). "Software" has been stated in the same publication to E describe "programmes which consist of instructions recorded on punched cards, magnetic tapes and discs. These devices instruct the computer as to what function it will perform" to produce the desired output. In a judgment delivered by the Supreme Court of Illinois in the case of *First National Bank of Springfield* v. *The Department of Revenue,* it was observed :

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> "In the computer industry, computer hardware is the tangible part of the machinery itself. Software denotes the information loaded into the machine and the directions given to the machine (usually through the media of punch cards, discs or magnetic tapes as to what it is to do and upon what command. Software also may include counseling and expert engineering assistance furnished by the seller of software, as well as flow charts and instruction manuals.....
>
> There are two basic types of software programs. An operational program controls the hardware and actually makes the machine operate. It is fundamental and necessary to the functioning of the

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hardware. An applicational program is designed to perform specific functions once the programming information is fed into the computer." A

Tariff Item 33DD of the earlier Tariff dealt with "computers (including central processing units and peripheral devices), all sorts". B

The present tariff deals with computers in Chapter 84. Heading 84.71 reads thus :

> Automatic data processing machines and units thereof; magnetic or optical readers, machines for transcribing data on to data media in coded form and machines for processing such data, not elsewhere specified or included." C

Chapter Note 5(a) states :

> "5. (a) For the purposes of heading No. 84.71; the expression 'automatic date processing machines' means : D
>
> (i) Digital machines, capable of (1) storing the processing programme or programmes and at least the date immediately necessary for the execution of the programme; (2) being freely programmed in accordance with the requirements of the user; E (3) performing arithmetical computations specified by the user; and (4) executing, without human intervention, a processing programme which requires them to modify their execution by logical decision during the processing run;"

Heading 85.24 deals with "records, tapes and other recorded media for F sound or other similarly recorded pheonomena, including matrices and masters for the production of records and includes gramophone records, audio tapes, audio cassettes, video tapes, video cassettes, magnetic discs and other cassettes and discs". Chapter Note 6 states :

> "6. Records, tapes and other media of heading No. 85.23 or 85.24 remain classified in those headings, whether or not they are cleared with the apparatus for which they are intended." G

For the sake of completeness, it must be noted that a Notification dated 1st March, 1989, issued in exercise of the powers conferred by Section H

A 5A(1) of the Central Excises and Salt Act, 1944, gives to "computer software falling under Heading 85.24 of the Schedule to the Central Excise Tariff Act, 1985," exemption from the whole of the excise duty leviable thereon.

B The Tribunal in the judgments that are impugned proceeded upon the basis that the appellants sold computer systems and that a computer system was incomplete without systems software inasmuch as mere hardware without systems software did not make the system workable. It relied upon its earlier judgment in the case of *Collector of Central Excise, Bangalore* v. *Sunray Computers Private Limited,* (1988) 33 ELT 787, in this C behalf. That judgment observed that "without software the hardware was incomplete, a mere dumb box and of no use at all to the customer. If there was a single contract for the supply of a computer including software the total value of the computer including that of the software would have to be assessed to duty irrespective of the fact whether the software part is D supplied along with the hardware or in a separate lot and irrespective of the fact whether a single invoice is made for both hardware and software or a separate invoice is made for the software." The Tribunal held that the excise liability of the computer system had to be determined with reference to the computer system itself and for assessment of the computer system it was immaterial whether the software was a brought out item. In the E assessment of the computer system an individual part lost its independent identity and became a part of the computer system.

The appellants before us have sold only a computer, or a computer along with software, and the software might have been imported or brought F out. Some contracts in this behalf are lump-sum contracts and some are for the computer and the software separately. Sample contracts are on the record.

Learned counsel for the appellants submitted that the test that had been applied by the Tribunal in the impugned judgments was erroneous. G Our attention was drawn to the judgment of this Court in *State of Uttar Pradesh* v. *M/s. Kores (India) Limited*, [1977] 1 SCR 837, where it was held that a typewriter ribbon was an accessory to a typewriter and not a part of the typewriter, though it might not be possible to type out any matter on the typewriter without the ribbon. This Court quoted with approval the H following observation of the High Court of Mysore in *State of Mysore* v.

Kores (India) Ltd. :

> Whether a typewriter ribbon is a part of a typewriter is to be considered in the light of what is meant by a typewriter in the commercial sense. Typewriters are being sold in the market without the typewriter ribbons and therefore typewriter ribbon is not an essential part of a typewriter so as to attract tax as per entry 18 of the Second Schedule to the Mysore Sales tax Act, 1957."

On the same reasoning, it was submitted, the software that was sold by the appellants along with their computers was not an essential part of the computers. What a computer was had to be judged in the light of its, commercial sense and, in that sense, the software was not understood to be a part of the computer. Reference was made to Section 80HHE of the Income-tax Act which provides for deduction of profits from export of "computer software" Reference was also made to the provisions of the Copyright Act, 1967, where a computer is defined as including any electronic or similar device having information processing capabilities and a computer programme' is defined to mean a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result. Interestingly, the Copyright Act defines 'literary work' to include computer programmes, tables and compilations including computer data bases. Reference was also made to the aforementioned contracts which indicate the distinction that buyers made between the computer and the software.

In the appeals of Wipro Information Technology Limited and PSI Data Systems Limited, the charges for installation of the computer and the training of the purchaser's personnel to operate and maintain it were also included in the assessable value of the computer, and the argument that was advanced in respect of the value of the software was also advanced in respect of these charges.

Learned counsel for the respondent, fairly did not dispute that the value of the software that the appellants might sell with their computers, if so ordered by the purchaser thereof, could not be included in the assessable value of the computers. He was, however, at pains to urge that this did not apply to the firm software that was etched into the computer; this is not even the appellants' case.

A In the first place, the Tribunal confused a computer system with a computer what was being charged to excise duty was the computer.

Secondly, that a computer and its software are distinct and separate is clear, both as a matter of commercial parlance as also upon the material on record. A computer may not be capable of effective functioning unless B loaded with software such as discs, floppies and C.D. rhoms, but that is not to say that these are part of the computer or to hold that, if they are sold along with the computer, their value must form part of the assessable value of the computer for the purposes of excise duty. To give an example, a cassettee recorder will not function unless a cassette is inserted in it; but C the two are well known and recognised to be different and distinct articles. The value of the cassettee, if sold along with the cassettee recorder, cannot be included in the assessable value of the cassette recorder. Just so, the value of software, if sold along with the computer, cannot be included in the assessable value of the computer for the purposes of excise duty.

D Having regard to the view that we take, it becomes unnecessary to deal with the subsidiary arguments on behalf of the appellants and the intervenor, M/s. Digital Equipment (India) Limited.

The appeals are allowed and the judgments and orders under appeal are set aside. There shall be no order as to coats.

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T.N.A. Appeals allowed.