No Service Tax Only on Reason Updates are Provided – Supreme Court in Quick Heal Technologies Limited

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The Supreme Court in the recent matter of Quick Heal Technologies Limited[1] has rejected the tax authorities claim of service tax on the amounts that are collected towards sale of anti-virus software. The Supreme Court followed its previous decision of Tata Consultancy Services[2] in reaching the above conclusion. In this article, we deal with the approach adopted by Supreme Court in arriving at the conclusion.

Issue:

The assessee (Quick Heal Technologies Limited) was engaged in development of anti-virus software under the brand of 'Quick Heal'. The same is supplied along with the license code/product code either online or on the replicated CDs/DVDs to the end-customers in India. The tax authorities has demanded service tax on such sale of anti-virus software for the period 01.03.2011 to 31.03.2014 (covering both the positive and negative list regime). The main contention of the tax authorities to demand the service tax is that the assessee, apart from the sale of the above software in canned form, also provides periodical electronic updates and such provision of periodical electronic updates to the software already sold is subjected to service tax.

The matter when reached Tribunal, the same was held against the tax authorities. The Tribunal stated that the anti-virus software which was sold by assessee does not have an element of interactivity and hence does not fall under the definition of 'information technology software' provided in both positive and negative list and accordingly not taxable. The Tribunal then proceeded to reject the claim of the tax authorities by placing reliance on the decision of Tata Consultancy Services (supra), wherein it was held that the sale of canned software or pre-packaged software would be treated as sale of goods. The final leg on which the Tribunal's rejection stood is the CBEC[3] guidelines which clarified that pre-packaged/canned software would not be goods even if there was a license. Accordingly, the Tribunal has rejected the entire tax demand which was confirmed by the tax authorities. The tax authorities were in appeal before the Supreme Court.

Arguments of Revenue before Supreme Court:

The revenue argued that the decision in Tata Consultancy Services (supra) was erroneously applied to the facts of the instant case by Tribunal. They have argued that the issued before Supreme Court in Tata Consultancy Services (supra) was whether canned software which was 'intangible property' would fall under the definition of 'goods'? and not whether the canned software can be called as 'goods' or 'service'. Since there was no argument that the canned software being 'service', the Supreme Court in Tata Consultancy Services (supra) did not make any comment as to possibility that canned software can also be called as 'service'. Hence, the reliance by Tribunal is clearly misplaced and accordingly prayed that the order need to be set aside.

[1] [2022] 141 taxmann.com 146 (SC)
[2] (2005) 1 SCC 308
[3] Central Board of Excise and Customs

The revenue contended that entire transaction of selling or trading of software can be divided into two stages:

a. Upto replication of master CD by the replicators under the terms of agreement
b. **Supply to end-users under a separate EULA[4], which consists of two parts:**
    i. **Supply of Anti-virus software in CD**
    ii. **Providing Electronic Updates to software originally provided**

It was contended that present dispute is one relating to part (b) in the above transaction. The revenue agrees that the part (a) in the above transaction is covered by the judgment of Tata Consultancy Services (supra) and not part (b). The revenue placed reliance on the judgment of Madras High Court in M/s Infotech Software Dealers Association[5], wherein it was held that sale of packaged anti-virus software to the end user by charging licensee fee as per the end user license agreement amounts to service and not sale, based on the nature of transaction.

Arguments by Assessee before Supreme Court:

The assessee argued that the Tribunal is right in holding that the software sold is not interactive and hence there cannot be any tax since it does not fall under the definition of 'information technology software'. The Tribunal holding that a programme could be said to be interactive only when it involves the user to have exchange of information or when there is action and communication between the user and software, cannot be faulted with. The assessee argued that the transaction cannot be bifurcated into two components as argued by revenue. The reason being that when pre-packaged anti-virus software which is sold in the box has a condition of sale that updates for the period of license would also be provided to the person who has purchased the goods without any further consideration. Hence, it argued that these updates are part and parcel of the sale of software itself and cannot be divorced from the transaction and treated separately as a service. The assessee placed reliance on the decision of BSNL (supra) and argued that the contract cannot be vivisected or split out and once a lumpsum has been charged for the sale of CD and sales tax has been paid thereon, the revenue cannot levy service tax on the entire sale consideration once again on the ground that the updates are being provided. Placing reliance on Imagic Creative Private Limited[6], they have argued that the service and VAT are mutually exclusive and since, VAT is already paid, there cannot be demand of service tax.

Analysis by Supreme Court:

The Supreme Court after referring to the order of Tribunal stated that the Tribunal has laid much emphasis on the fact that in accordance with the agreement the licensee has the right to use the software subject to conditions laid therein. The fact that the licensee is entitled for the updates and technical support from the assessee post sale of the anti-virus software has made the Tribunal to reach a conclusion that the above is a 'deemed sale' and hence would be out of the definition of 'service'. The revenue on the other hand argued that the said transaction does not fall under the ambit of 'deemed sale'.

[4] End User Licensing Agreement
[5] 2010 (20) STR 289 (Mad)
[6] (2008) 9 STR 337 (SC)

The Supreme Court after referring to the judgments of Tata Consultancy Services (supra), Associated Cement Companies Limited[7], 20th Century Finance Corporation Limited[8] and BSNL (supra) has culled out the principles as to what constitutes right to use under Article 366(29)(d) of Constitution and held that the sale of anti-virus software falls under the ambit of the said article to be called as 'deemed sale'. The Supreme Court by placing reliance on BSNL (supra) concluded stating that once a lumpsum has been charged for the sale of CD and sale tax has been paid thereon, the revenue thereafter cannot levy service tax on the entire sale consideration once again on the ground that the updates are being provided. The Court rejected the artificial segregation of the transaction, as done by revenue in the instant case, by stating that in substance the transaction is sale of software and once it is accepted that the software put in CD is 'goods', there cannot be any separate service element in the transaction. The Court concluded by stating that even otherwise the user is put in possession and full control of the software making it a 'deemed sale', which is out of ambit of service tax. Accordingly, the Supreme Court rejected the contention of the revenue.

Remarks:

It appears that the main reason for rejection of the demand of service tax was that there was no separate consideration charged for provision of the updates. If there is a separate consideration charged, whether the above decision will hold good? Alternatively, if there is a period during which the updates are provided free of cost and later updates being chargeable, then whether, the above decision will hold good? In such cases, whether the consideration appears to be different, will that be subjected to service tax? These are important questions which will come up in due course of time before the Supreme Court.

[7] (2001) 4 SCC 593
[8] (2000) 6 SCC 12