

# Tax Hotline

November 16, 2004

## CANNED SOFTWARE REGARDED AS GOODS, HELD LIABLE TO SALES TAX

A recent ruling pronounced by the Supreme Court, the apex court of India, sets at rest the ongoing controversy regarding the applicability of sales tax on sale of Off-the-Shelf Software Packages/Canned Software/Shrink Wrap software. The question before the apex court in the case of Tata Consultancy Services ("**Appellant**") was whether intellectual property contained in media such as floppies, disks, CD-ROMS, magnetic tapes, or similar medium could be held to be "goods" and hence subject to sales tax.

In this case, the Supreme Court held that though software may be an intellectual property, such intellectual property contained in a medium, which can be bought and sold, would be treated as "goods", and hence subject to sales tax. While examining the issue, the Supreme Court discussed the definition of "goods" under various Indian enactments, and acknowledged that its meaning is wide enough to cover software contained on any medium. Additionally, the judgment also enumerates various Indian and international cases relied upon by the Appellant and the income tax authorities. Further, it was also acknowledged by the court that the question under consideration was not in respect of a computer program which is not a part of a disk, but that which is contained in a disk/ other media.

The court also discussed the meaning of the term "canned software" and held that the software marketed by the Appellant indisputably fell within the purview of such meaning. Each of the medium on which the software is sold is not only easily available for a price but is also circulated as a commodity in the market. Whether providing an instruction manual with the software would make the software intangible was held in the negative. The court held that such manuals are supplied with several other goods including electronic goods and that does not affect their characterisation. The court reiterated that what was essential for an article to become goods was its marketability.

In view of, inter alia, the above, it was held that the software being sold by the Appellant would be regarded as goods, subject to sales tax in India. An inference may be drawn for direct tax law purposes from this judgment that there is no transfer of copyright on sale of such canned software. Hence, payment made for purchase of shrink-wrapped/canned software should not be treated as royalty for income tax purposes. On a separate note, based on the recommendations made by the Emerging Issues Task Force, a clarification on taxation of software payments under the direct tax laws, is shortly expected from the Central Board of Direct Taxes, India.

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