



**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

MAHARASHTRA VALUE ADDED TAX APPEAL NO.21 OF 2015

Atos India Private Limited)
Plant 5, Godrej, Pirojshanagar, LBS Marg, Vikhroli)
(West), Mumbai – 400 079)Appellant

V/s.

1. The State of Maharashtra)
Mantralaya, Mumbai)
2. Commissioner of Sales Tax,)
Maharashtra State, Mumbai,)
8th Floor, Vikrikar Bhavan,)
Mazgaon, Mumbai – 400 010)Respondents

Mr. D.B. Shroff, Senior Advocate a/w. Ms. Chandni Tanna and
Mr. Prathamesh Chavan i/b. India Law Alliance for appellant.
Mr. Himanshu Takke, AGP for respondents – State.

**CORAM : K. R. SHRIRAM &
DR. NEELA GOKHALE, JJ.
RESERVED ON : 8th DECEMBER 2023
PRONOUNCED ON : 18th DECEMBER 2023**

JUDGMENT (PER K.R. SHRIRAM, J.) :

1 The appeal was admitted on 8th December 2015 and the
following four questions of law were framed :

(1) Whether the agreement dated 1 January 2006 between the Appellant and M/s. QAD India Private Limited is a contract of services or a contract of supply and/or sale of software by the Appellant?

(2) Whether the Tribunal erred in not following the decision of the Hon'ble Karnataka Sales Tax Tribunal in the case of M/s. IBM India Pvt. Ltd. vs. State of Karnataka [2010 (ST1) GJX 0761 TKAR] and the judgment of the Hon'ble Karnataka High Court in the case of Saskan Communication Technologies Limited vs. Joint Commissioner of Commercial Taxes [2012 (ST2) GJX 0659 KAR] which directly and squarely apply to the facts and circumstances of the present case?

(3) Whether the Tribunal, being the last fact-finding authority, erred in not taking into account the Affidavit dated 18.12.2014 as relevant evidence of conduct of the parties to the Agreement dated 1.1.2006 and to determine the nature of the services and the work performed thereunder to arrive at the correct factual position of the activity performed by the Appellant?

(4) Whether the services provided by the Appellants to M/s. QAD India Private Limited under the Agreement dated 1 January 2006 for removing or fixing of bug/error within the basic software, which is in the nature of repair of the basic software, amounts to development/enhancement/customization of the existing software?

2 Appellant is engaged in providing services relating to repair and maintenance of software. Appellant holds Service Tax Registration bearing No.AAACO2461JST001. Appellant is also registered under the provisions of the Maharashtra Value Added Tax Act, 2002 (the MVAT Act) bearing TIN 27120364214V.

3 Appellant had executed an agreement with one QAD India Private Limited (QAD) to provide manpower to perform maintenance services as desired by QAD in relation to Enterprise Resource Planning (ERP) software called MFG/PRO. The agreement was for the period 1st January 2006 to 31st December 2006. The agreement provided the scope of work. Under the agreement, appellant was to provide to QAD a team of 9 employees to perform services at the rate of US \$ 4200 per person per month.

4 QAD Inc., USA is a software development company and is the owner of the source code of ERP software MFG/PRO. The software is

purchased by the users/customers directly from QAD Inc., USA. QAD has full control and maintains the core software and has outsourced only the bug fixing to appellant. Appellant's employees work on the QAD servers located in USA through remote access as per the work statement. The employees of appellant assigned to QAD were performing services as per the instructions and under the supervision and control of QAD.

5 QAD has not delivered its software to appellant and only QAD possessed all rights of ownership in respect of MFG/PRO software. The software was supposed to function in a pre-determined manner. In case the software did not provide the desired results (in case of a bug/error) appellant would resolve only the error/bug.

6 MVAT authorities conducted a business audit in the year 2009 for the period 2005-2006 to 2007-2008. During the course of audit, to queries raised, appellant explained to the MVAT authorities that appellant was only providing manpower services in the nature of work on hire basis. Copy of the agreement with QAD was also provided. So also copy of invoices. It was explained that appellant has merely worked on the property belonging to QAD and, therefore, cannot create any copyright over the software. As the audit officers were not accepting appellant's explanation, under the provisions of Section 56 of the MVAT Act (as it was then in force), appellant applied for determination of disputed questions under Section 56

of the MVAT Act. The application was filed before the Commissioner of Sales Tax seeking clarification regarding the ambiguity on applicability of VAT on services related to repair/maintenance of software. The Commissioner of Sales Tax, by an order dated 18th October 2012, held that appellant's case would fall under the definition of sale as per Section 2(24) of the MVAT Act. It was held that services provided by appellant to QAD are subject to VAT.

7 Impugning this order of Commissioner, appellant preferred an appeal before the Maharashtra Sales Tax Tribunal at Mumbai (the Tribunal). It was appellant's case that services provided by appellant to QAD cannot be construed as sale under the MVAT Act and no VAT should be applicable on the same. The appeal was rejected by the impugned order dated 3rd February 2015. The Tribunal also concluded, relying on various judgments and in particular in the case of *Mastek Ltd. V/s. State of Maharashtra*¹ decided by the Tribunal on 15th March 2013, that the service rendered by appellant under the agreement with QAD would amount to sale under the provisions of Section 2(24) of the MVAT Act.

8 The Tribunal of course has accepted that when the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. The agreement in the case at hand is the agreement dated

1 2013-(ST1)-GJX-0239-STMAH
Gauri Gaekwad

1st January 2006 entered into between appellant and QAD. Therefore, the issue in the present case is whether the agreement dated 1st January 2006 between appellant and QAD a pure service contract as contended by appellant or a contract of sale of software as contended by respondent. Respondent has proceeded on the basis that whilst carrying out bug fixation for QAD Inc., USA, appellant had embeded codes into the source code of the ERP and this amounted to development of software and that this developed software was sold to QAD under the agreement dated 1st January 2006 and hence, there was a sale.

9 Appellant has explained what is the ERP software as under :

(a) An ERP Software is an integrated management software to manage core business processes, where only one software is required and it is not necessary to have different software like finance, production, sales, procurement etc. The fundamental distinction between an ERP and a standalone software is that an ERP cannot be fundamentally changed. Third parties like appellant do not have access to the source code in the ERP. The source code is the heart of the intellectual property and is never parted by the owner of the ERP. The present ERP is QAD Inc. USA's proprietary system.

(b) Such ERP software is not designed exclusively for use by a particular type of enterprise/business. Such software is designed for use by

the different types of enterprises. By its very nature, such software needs to be made suitable for use by the concerned purchaser of such software so as to be of use to him. To do so, the ERP software has built-in gaps which are in the nature of virtual switches. Qualified professional (such as appellants' engineers) merely operates these virtual switches and disables all unneeded options whilst enabling only that option which suits the customer's requirements. What appellant does to make the proprietary ERP software usable/compatible for the customer cannot constitute goods because enabling or disabling such virtual switches cannot be considered as some new or different software from the ERP software, that is capable of being possessed, marketed or transferred by the customer or QAD to anyone else. In other words, no marketable commodity comes into existence that can be sold.

(c) This can also be understood with the example of software programme such as Microsoft Excel, which is used to perform various spreadsheets and calculation functions. In order to get a desired mathematical calculation in a spreadsheet, a particular kind of mathematical formula is required to be inserted. The customer is not aware of the mathematical formula and this is provided by the qualified personnel to whom the work is entrusted. In this, using an application of a particular module, say Macros, to train Microsoft Excel for a particular need or a step-by-step process to get the desired report, may be viewed comparable to

services of appellant, i.e., to remove bugs and make the software suitable for use by the concerned purchaser so that the existing ERP system developed by QAD delivers what is expected out of it for the end customer. Such work does not tantamount to development of new version of the software.

10 Mr. Shroff submitted as under :

(a) Under the agreement entered into between appellant and QAD, appellant is merely required to provide its manpower to render services of maintenance and support of the said ERP. Under this agreement, appellant had been outsourced to provide support (that included fixing various bugs that might occur). Whenever the customer in India, who operates the base software (MFG/PRO) has some problem with the operation of the said software, a complaint is lodged with QAD, who then outsources the complaint to appellant. The main software is located on QAD Inc. USA's server. Appellant's employees worked on such QAD servers remotely and resolved the said bugs that the end-customers complained of, for which appellant was paid at the aforesaid rate. It is pertinent to note that even if there was no complaint or the bug could not be resolved, appellant would receive the aforesaid payment of US\$ 4,200 per month for each of the 9 employees assigned to QAD under the agreement. As per the agreement, QAD was required to pay to appellant the said fee within

10 days after the end of each calendar month in accordance with the invoice sent to QAD for services performed under the agreement;

(b) The term “software program” has been discussed in the case of *Tata Consultancy Services V/s. State of Andhra Pradesh*² and *BSNL & Anr. V/s. Union of India*³ wherein the Supreme Court has defined software as a set of instructions expressed in words, code 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. Thus, it is a complete code, functioning independently in the computer. In the present case, the above conditions are not satisfied as providing repair/maintenance services for the existing software no goods are brought into existence. Even though the codes/command come into existence they cannot be bought and sold in the market as such. The commands/codes only help in the functioning of the base software as per the requirement of the customer. Therefore, in the absence of complete code of instructions to perform computer operations the set of commands cannot be termed as software;

(c) There can be transactions in case of computer software which do not involve any transfer of property in software (either as a part of a deemed sale or as a result of another sale), but which would involve a person or a dealer providing manpower or technical services for agreed

2 (2004) 137 STC 620 (SC)

3 (2006) 145 STC 91 (SC)

Gauri Gaekwad

consideration (based on man hour or such other basis) to any other dealer or any other person to program/develop software for such other person or dealer at the premises of the former or the latter. In such transactions, the software so developed/programed would be the property of the latter and the former would not have any ownership over such software developed/programed.

The Karnataka Sales Tax Tribunal in the case of ***IBM India Private Limited, Bangalore V/s. State of Karnataka***⁴ has held that adding lines of codes into the ERP at places where the ERP software permits such additions/modifications to be made were not held to be software. Similarly, in the present case, the technical services provided by appellant to QAD, i.e., adding of lines of code within the base software itself to fix bug/error, would not amount to software or sale of software;

(d) The lines of code, although added does not alter the character of the base software and it does not acquire any new form and as the instructions/lines of code added by appellant to the base software are not capable independently of being possessed, marketed or transferred to anyone else, it cannot be termed or treated as “software”. Hence, in the present case the process of developing software does not take place;

(e) Since no software is coming into existence, there cannot be transfer of the same. Hence, there are no goods which get sold;

4 (2010) ST1 GJX 0761 TKAR
Gauri Gaekwad

(f) The Hon'ble Supreme Court of India in the case of ***Vikas Sales Corporation V/s. Commissioner of Commercial Taxes and Another***⁵ and in the case of ***Union of India and Another V/s. Delhi Cloth and General Mills Company Limited***⁶ observed that in order to treat a subject matter as “goods” it is essential that the following conditions are satisfied :

The subject matter must be capable of being brought to the market to be freely bought and sold

It must be dealt with in the commercial world as merchandize and goods.

Further, in the case of ***Bharat Sanchar Nigam Ltd. & Anr. V/s. Union of India & Ors.***⁷ the Supreme Court observed :

Every item of goods necessarily has to have a name thereto or a label thereon by which it can be described in specific terms and the bargain of goods requires the specification of goods particularly when they are intangible goods. If there were to be a bargain for any intangible goods between the Appellant company and the concerned buyers then there would have been in existence a description of the goods which are the subject matter of bargain.

The line of codes added to the base software in order to rectify an error or bug cannot be treated as software (“goods”) which can be brought to the market to be freely bought and sold. Applying the above test to the instant case, it is established that the consideration received by appellant cannot be considered as consideration for transfer of goods. Thus, the transaction should not be exigible to VAT.

5 AIR 1996 SC 2082

6 AIR 1963 SC 586

7 AIR 2006 SC 1383

Gauri Gaekwad

In the present case, such description of goods namely, description of the concerned program in specific terms is not found in the agreement which clearly shows that appellant and QAD never intended of creating any goods (software). The codes inserted by appellant within the base software are not proprietary codes having a marketability of their own which appellant can possess or transfer or sell. Appellant was merely engaged in the activity of providing repair/maintenance services and it was a pure service contract. Thus, there is no sale of any intangible goods in the form of software from appellant to QAD;

(g) Repair and maintenance of software in this case was to make it function in the way it was intended to at the time of purchase. Fixing of bug neither resulted in change of source code nor did it result in creation of a new version of the software;

(h) Similarly, in the case of ***Thermax Babcock & Wilco Limited V/s. State of Maharashtra***⁸ it was held that when intellectual services are rendered in the form of corrective actions to restore the original functionality, it is purely a service contract and is not exigible to tax under Sales Tax laws. In the present case, the intellectual services are provided by appellant to QAD technicians in the form of lines of codes/commands within the base software itself to remove a bug/error which does not qualify as “goods” as the same is not put on a medium for sale. Even if

8 2007 (ST3) GJX 0247 STMAH
Gauri Gaekwad

software/“good” is created it does not belong to appellant. The Commissioner has grossly erred in assuming that there is a transfer of intellectual property by appellant to QAD. Even if it is assumed that the goods come into existence, still there will be no liability of appellant;

(i) Clause 4 of the agreement executed between appellant and QAD is reproduced below for ease of reference :

Clause 4 - Ownership of work

All rights of ownership in all materials, products and work produced and/or provided by AOI or its employees, including the rights to ideas or inventions and rights under patent, copyright, trademark, trade secret and other applicable laws for services performed under any Work Statements shall belong exclusively to QAD, and shall be deemed works made for hire in the course of the services performed hereunder. For those copyrightable materials, products and works produced and/or provided by AOI hereunder, both parties agree that QAD and/or its designated entity shall be the author of such materials, products and works. Unless otherwise provided under this Agreement. AOI has no rights to utilize the said materials, products and works in any manner whatsoever without obtaining the express license from QAD. QAD shall have the right to obtain and to hold any copyrights, patents, registrations or such other protection as either may require. To the extent that title to any such work may not, by operation of law, vest in QAD, or such works may not be considered works made for hire, all rights, title and interest therein, are irrevocably assigned to QAD.

From the above clause, it is clear that the intellectual property rights in the software application from the very beginning was the exclusive property of QAD and appellant has no ownership rights in the same at any point of time. Therefore, there are no goods in the hands of appellant, which can be transferred and, therefore, no sale has taken place. Appellant

has merely worked on the property belonging to others and cannot create any copyright over the software. The software developed (if any) from the very inception is the property of QAD. Thus, the question of transferring the rights to use the software does not arise at all. The Tribunal has misinterpreted the said Clause since it only means that appellant cannot claim any proprietary and intellectual property rights in respect of services rendered. The said Clause does not and cannot mean that appellant is supplying much less selling software. The Tribunal has failed to appreciate that in terms of Clause 11 of the agreement appellant is required to carry out activities as mentioned in the works statement. From a plain reading of the works statement it is unequivocal and unambiguous that appellant is rendering services.

The Tribunal erred in holding that Clause 4 states the assignment of rights into software and/or that the same discloses emergence of software programme which is goods. Furthermore, Clause 4 is a deeming provision inserted out of abundant caution and a contractual bar on appellant to claim intellectual property rights in the course of rendering services. The Tribunal failed to appreciate that Clause 4 is restricted in its operation “for services performed under any works statement” and the expression “shall be deemed works made for higher of services performed hereunder” which clearly shows that the agreement is a contract for services and that the said Clause has been inserted to put potential dispute,

Gauri Gaekwad

if any, to rest and out of abundant precaution between the parties. But Clause 4 does not have the effect of changing the basic structure of the agreement.

To further substantiate the above view, reference can be made to the judgment pronounced by the Karnataka High Court in the case of *Sasken Communication Technologies Limited V/s. Joint Commissioner of Commercial Taxes (Appeals)-3 Bangalore and Anr.*⁹ wherein the Karnataka High Court held that in case the assessee had, even before development of software, given up all rights and claims of software to be developed and had expressly agreed that such a software which may come into existence at the end of contract period was absolute property of customer, such a contract did not indicate a sale of any software but was a contract for service. The said principle shall squarely apply in the present case;

(j) The Commissioner has, in his order, referred and relied upon the DDQ Order pronounced in the case of *Mastek Limited* (Supra). The Tribunal has also relied upon the order passed in the case of *Mastek Limited* (Supra) and erroneously passed the impugned order.

The services performed by appellant as per the agreement with QAD are different and distinct from those provided by Mastek Limited to HDFC Bank Limited.

9 2012 (ST2) GJX 0659 KAR
Gauri Gaekwad

In the present case, appellant was responsible merely for fixing a bug/error in the software which is entirely different from the activity undertaken in the case of *Mastek Limited* (Supra). In *Mastek Limited* (Supra) existing software had to be modified to make it compatible with the requirements of the customer. However, the job of appellant in the present case was merely to restore the software to its intended functionality by removing the error. The activities undertaken were in the nature of “trouble-shooting” wherein fault reports or calls are booked by the client and the same is resolved by appellant.

11 Mr. Takke submitted as under :

(a) The agreement entered into between appellant and QAD was for modification, development, enhancement and customization of the standard software MFG/PRO. The maintenance of software is not the same as maintenance of plant and machinery. The maintenance and modification and bug repair would require independent code, which is required to be written on the standard software, which would amount to software development as stated in *Mastek Limited* (Supra);

(b) The agreement in the case at hand is similar to the agreement in *Mastek Limited* and, therefore, the same is fully applicable in the case at hand;

(c) The meaning of term “goods” is extremely wide and the software is the “goods” as held by the Apex Court in *Tata Consultancy Services V/s. State of Andhra Pradesh*¹⁰ and *BSNL V/s. Union of India*¹¹;

(d) Clause 4 of the agreement provides for ownership of the work. It provides that appellant would deliver to QAD all materials developed in connection with the services rendered under such work statement on full payment due and payable. The ownership of the software developed including the copyright therein would be transferred on delivery and, therefore, the contract providing for development, enhancement and customization is an agreement to sell and purchase of software, which would come into existence by employing the skill of employee of appellant. Since the agreement is for sale and purchase of modified, developed and customized software, the Tribunal was right in holding that the transaction would fall within the meaning of Section 2(24) of the MVAT Act;

(e) As rightly stated by the Tribunal, the entire subject matter as to whether there is a sale under the provisions of MVAT Act would depend on the terms and conditions of the agreement dated 1st January 2006.

12 Let us examine the provisions of the agreement which read as under :

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10 (2004) 137 STC 620 (SC)

11 (2006) 145 STC 91 (SC)

Gauri Gaekwad

WHEREAS, QAD desires to obtain services and AOI agrees to provide these services in accordance with Work Statements (substantially in the form of Exhibit A) that QAD and AOI may enter into subject to this Agreement.

THEREFORE, in consideration of the terms and conditions set forth in this Agreement, QAD and AOI agree as follows :

1.0 Services -

1.1. AOI agrees to provide to QAD its employees as expressly requested by QAD under and identified in the attached Work Statements to perform the services at the location, for the periods, at the rates, and subject to such conditions as may be set forth in the Work Statements that may be entered into from time to time between AOI and QAD. In the event of a conflict between these terms and a Work Statement, the terms stated in the Work Statement will take priority and prevail.

1.2. AOI represents and warrants that all services performed by its employees hereunder will be rendered in a good and workmanlike manner and in accordance with industry practice. AOI'S employees shall also comply with QAD and QAD's Customer's work rules and policies of which AOI or its employees become aware or is expected to know.

1.3. Upon QAD's request, AOI's employees shall promptly and timely provide QAD with reports and/or descriptions of services they performs and time reports as QAD may request.

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3.1. QAD agrees to pay AOI in accordance with the agreed fee set forth in Exhibit B upon receipt of AOI's invoice.

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4.0. Ownership of work -

All rights of ownership in all materials, products and work produced and/or provided by AOI or its employees, including the rights to ideas or inventions and rights under patent, copyright, trade mark, trade secret and other applicable laws for services performed under any Work Statements shall belong exclusively to QAD, and shall be deemed works made for hire in the course of the services performed hereunder. For those copyrightable materials, products and works produced and/or provided by AOI hereunder, both parties agree that QAD and/or its designated entity shall be the author of such materials, products and works. Unless otherwise provided under this

Agreement, AOI has no rights to utilize the said materials, products and works in any manner whatsoever without obtaining the express license from QAD. QAD shall have the right to obtain and to hold any copyrights, patents, registrations or other such protection as either may require. To the extent that title to any such work may not, by operation of law, vest in QAD, or such works may not be considered works made for hire, all rights, title and interest therein, are hereby irrevocably assigned to, or when they come into existence, are irrevocably assigned to QAD. AOI agrees to give QAD, or any person designated by QAD, reasonable assistance at QAD's expense required to perfect the rights set forth in this Section. Upon the completion of services under any Work Statement and subject to full payment due and payable to QAD, AOI shall immediately deliver to QAD all materials and deliverables developed in connection with the services rendered under any such Work Statement.

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7.2. AOI warrants that the services performed and/or any works or deliverables provided by AOI hereunder will conform to the specifications of the applicable service description. For the period (30) days, AOI will remedy, without charge to QAD or QAD's customer, any and all parts of the works or deliverables which QAD or its customer find to be non-conforming.

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Description of Service to be performed :

1) Resolving Problem Reports in the form of Service Requests or Incidents, necessitating modification of the Standard Product of MFG/PRO as per QAD Development Standards.

2) Development for Just in Time/Sequencing Products (JIT/S).

3) Development/enhancement/customization in any QAD product(s).

Other Considerations :

Atos Origin to provide :

Personnel -

For Standard Product Support :

A team of 9 with the following qualifications (which may be supplemented by on-the-job experience)

** All resources must possess at least 1 year of Progress experience.*

** At least 50% must possess at least 1 year of MFG/PRO Experience.*

** At least 2 individual with 4 years of experience in Progress or MFG/PRO.*

** At least 2 individuals with 2 years of experience in Progress or MFG/PRO.*

** A good understanding of QAD Maintenance Processes and Procedures should be there.*

For JIT/S (through 30-April-2006)

A Team of 1 individual with the following qualifications (which may be supplemented by on-the-job experience)

** Understanding of any ERP Fundamentals*

** 1 Year experience in Progress*

** Working experience of Progress Dynamics*

** 1 year experience in MFG/PRO.*

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US \$ 4200/month/person (US Dollar Four Thousand Two Hundred only per person per month) for all categories of AOI employees.

13 The most important clause from the clauses in the agreement for the subject matter at hand is Clause 4 as quoted above on which great emphasis has been placed by respondent. Clause 4 of the agreement, which deals with “Ownership of Work” categorically provided, *inter alia*, :

(a) that not only does the software belong to QAD but all rights of ownership in all materials, products that were produced and provided by appellant or its employees, including the rights to ideas or

inventions and rights under patent, copyright, trademark, etc., belong to QAD and shall be deemed to be works made for hire in the course of the services performed under the said agreement and in respect of such copyrightable materials, products and works produced it was QAD or its designated authority was deemed to be the author of such materials, products and works and appellant had no rights to utilize the said materials, products or works in any manner without obtaining an express license from QAD;

(b) this clause also provides that to the extent title to any such works may not, by operation of law, vest in QAD, they would deem to be irrevocably assigned to QAD the moment they came into existence;

(c) the said clause also provided that at the end of the contract all materials and deliverables developed in connection with the services rendered under any work statement would be immediately delivered to subject to full payment having been made. These materials and deliverables would be in the nature of all logs, analysis reports, paperwork, etc. and not in the nature of software as the software issues (bugs) have to be resolved on time and the work was done on QAD's servers situated in the USA.

It is this clause that has been totally misunderstood and misread by both the Commissioner as well as the Tribunal. The lower authorities have purported to hold that the said clause shows that there is a transfer of software that has come into existence. On the contrary the

Gauri Gaekwad

aforesaid clause appears to be, when the contract is read as a whole, a standard clause inserted into such contracts for repair and service and is a clause, it appears, to have been inserted by way of abundant precaution to overcome a situation where the service provider would misuse the QAD software or claim ownership over the same.

In fact, this clause shows that appellant had neither any ownership of the original software nor ownership of anything that came into existence whilst resolving customer issues. The said clause, on the contrary, shows that from the very inception everything belongs to QAD and the moment anything comes into existence by virtue of any work done by appellant's employees the same is deemed to have always been owned by QAD and appellant is not deemed to be the author of anything done. In fact, appellant was not even entitled to utilize any such work or material or product that may have come into existence and there could have been no question of any sale, as nothing belongs to appellant. When nothing belongs to appellant it is not possible to come to the conclusion that there was a transfer of goods or a sale as held by the lower authorities. The materials and deliverables that are to be handed over to QAD at the end of the contract could not have amounted to a sale of its software or its transfer. These materials and deliverables are the paperwork that may have been created by appellant's employees. In fact, the clause goes to the extent to provide that even if, by operation of some law the works do not vest in

QAD (which actually shows that all works best in QAD from inception) then also it will be irrevocably assigned to QAD the moment they come into existence. There is, therefore, no transferable sale even if we assume any new software has come into existence.

There is nothing to even indicate that QAD Inc., USA has outsourced or entrusted appellant with any work which involves any development of the said ERP, or work that results in a different commercial commodity, i.e., something other than MFG/PRO. QAD Inc., USA is a software development company and has full control over the core software (source code) itself and gives low-cost bug fixing services to companies like appellant. Even for such bug fixing there is complete control by QAD Inc. in that they have a full-time program manager working in appellant's office.

Third Parties like appellant come into the picture just to provide Annual Maintenance Contract (AMC) and bug fixing services to let the ERP function properly and hassle free. While providing these services, the source codes remain intact. Appellant has repeatedly submitted this before respondent no.2 that appellant's employees based in India work on QAD servers based in the USA through remote access. QAD has not delivered the software to appellant and appellant has not delivered back any developed software which has resulted into a different or transformed software other than the MSG/PRO.

14 Therefore, assuming that any software has been developed or there is some change in the source code, no new or saleable software comes into existence. Appellant's employees had merely worked on the old software remotely as the same is located on QAD USA's server situated in the USA. The alteration in such software is to meet the requirements of the QAD India's customer, which at all times belonged to the QAD India. There is no sale to QAD India, and no sale was involved in the contract. In fact, the terms of the contract makes it clear that the contract was one for rendering service. In fact, even before rendering any service, appellant had given up their right to any development to the software. The consideration involved is not for the sale of any software but for the services rendered by appellant's employees. All IT property rests with QAD India.

15 In *Sasken Communication Technologies Limited V/s. Joint Commissioner of Commercial Taxes (Appeals)-3 Bangalore and Anr.*¹² paragraphs 39 to 50 read as under :

39. From the aforesaid Clauses; it is abundantly clear that the parties have entered into an agreement whereby the assessee renders service to the client for development of software, i.e., for software development and other services. Pursuant to the agreement and the work orders, the service shall be performed by the assessee. Services must be requested by issue of a valid work order together with a statement of work. As compensation for the service rendered to the customer, the fees specified in the relevant work order or in the statement of work is payable and billing is done on a time and material basis or on a fixed price on a monthly basis. Pricing for time and material projects shall be fixed at a rate set forth in Annexure-A to the agreement.

¹² Writ Appeal Nos.90-113 and 118-129 of 2011 (T-RES)
Gauri Gaekwad

40. *The assessee agrees, that all patentable and unpatentable, inventions, discoveries and ideas which are made or conceived as a direct or indirect result of the programming or other services performed under the agreement shall be considered as works made for hire and shall remain exclusive property of the client and the assessee shall have no ownership interest therein. Promptly; upon conception of such an invention, discovery, or idea the assessee agrees to disclose the same to the client and the client shall have full power and authority to file and prosecute patent applications thereon and maintain patents thereon. At the request of the client, the assessee agrees to execute the documents including but not limited to copyright assignment documents, take all rightful oaths and to perform such acts as may be deemed necessary or advisable to confirm on the client all right, title and interest in and to such inventions, discoveries or ideas, and all patent applications, patents, and copyrights thereon. Both the source code of developed software and hardware projects of worldwide Intellectual Property in and each shall be owned by the client. The assessee acknowledges that all deliverables shall be considered as works made for hire and the client will have all right, title including worldwide ownership of Intellectual Property Rights in and each deliverable and all copies made from it. If acceptable to the client, the client may reuse all or any of the components developed by the assessee outside the scope of the those contracts for the execution of the projects under this agreement.*

41. *Therefore, even before rendering service, the assessee has given up his rights to the software to be developed by the assessee. The considerations under the agreement is not for the cost of the project, the consideration is for the service rendered, based on time or man hours. Once the project is developed, all rights in respect of the said project including the Intellectual Property rights vest with the customer and he is at liberty to deal with it in any manner he likes. The assessee has agreed to execute all such documents which are required for the exercise of such absolute rights over the software developed by the assessee.*

42. *The 'deliverables' has been defined under the agreement to mean all materials in whatever form generated, treated or resulting from the development including but not related to the software modules or any part thereof, the source code and or object code, enhancement applications as well as any other materials media and documentation which shall be prepared, written and or developed by the developer for the client under this agreement and/or Project Order. If the customer agrees to provide any hardware, software and other deliverables that may be required to carry out the development and provide the*

deliverables he may do so. Otherwise the assessee has to make or provide all those hardware and software to develop the deliverables and the final product. No doubt at the end of the day, this software which is developed is embedded on the material object and only then the customer can make use of the same. The software so developed even before it is embedded on the material object or after it is embedded on a material object exclusively belongs to the customer in the entire contract there is nothing to indicate that the assessee after developing the software has to embed the same on a material object and then deliver the same to the customer so as to have title to the project which is developed. The title to the project/software to be developed lies with the customer even before the assessee starts rendering service.

43. In the agreement or from any other material on record, there is nothing to indicate that the assessee purchases the software from the market, improves the same according to the specification of the client and then delivers the same to the client. On the contrary, the agreement clearly discloses that the assessee's technicians either work at their office or go to the place of the client, carry out the project work and find solutions and if at the end of the day, any software emerges, same is embedded on a CD. The software so developed, from the inception is the property of the customer. At no point of time the said software is the property of the assessee. Even before the software/goods came into existence, it was the property of the customer. The terms of the contract as set out above, do not indicate sale of any software. On the contrary, those terms make it very clear that the agreement is a simple service contract, whereunder the assessee provided its staff and its employees who are well trained in the field and who would develop the software according to the specification of the customer.

44. In fact, a careful reading of the agreement shows that, the employees of the assessee and the employees of the customer have to work hand in hand, consult at every stage, have interactions and understand the need and requirement of the customer and through their employees, the software is to be developed. The technicians of the assessee and the employees of the customer are working together at the project site. In most of the cases, the service rendered by the assessee is in the nature of making one of the inputs into a final product which is produced at the project place with the assistance of the staff of service providers. In fact, the material on record discloses that the customers have engaged the services of several service providers, who have expertise in different fields and all of them put their mind and hands together and find a solution to the problem of the customer. The end product, i.e., the ultimate software, is not necessarily the work of any one such service

provider. It is a collective effort. Nobody can claim that the end product exclusively belongs to them except the customer who has paid for the service rendered by the various service providers.

45. As clear from the terms of the agreement, on the day they entered into agreement, there was no software in existence. In other words, there was no goods in existence. The agreement is not for transfer of software. The agreement is for development of software. Even before the software comes into existence, the assessee has given up all the rights and claims of the software to be developed and has expressly agreed that such a software which may come into existence in the end of the contract period is the absolute property of the customer. The customer is at liberty to deal with that software in the manner he wants without further reference to the assessee. The consideration paid is not for transfer of any goods. The consideration paid is calculated in terms of time such as man days, man hours and man months. As on the date of entering into the contract, both the parties are not clear how much time the contract would ultimately take and when the end product, i.e., the software is produced.

46. Intellectual property comprises of all those things which emanate from the exercise of the human brain, such as ideas, inventions, poems, designs, etc. The word 'property' comes from the Latin word proprius, which means "ones own". Intellectual property means, the legal rights which may be asserted in respect of a product of human intellect. The fruits of intellect, would exist even if they enjoyed no legal protection.

47. Intellect is not property by itself. Through intellect, you can create intellectual property. It is that intellectual property that will become "goods" once put on a medium for sale. Intellectual property does not exist in the mind of the technician. What exists in his mind is the intellect. Using that intellect, a technician creates or develops "goods". It is that goods which is called intellectual property when put on a medium for sale. Therefore when a technician creates or develops an intellectual property, there is no element of transfer involved. When such intellectual property is put on a medium for sale, it is capable of being transferred. If transfer takes place, then, it constitutes sale of goods.

48. When a customer gives a software related problem to the technician, to find a solution, if the assessee has a ready made answer, in the form of a ready made software, such software is goods. It may be branded or unbranded software. All that the assessee has to do, is to transfer the goods. Then it amounts to sale of goods. On the contrary, if the assessee has no ready made

answer, he has to find an answer by using his intellect or of his employees and has to work on the problem using his intellect. That process is called development or creativity. In the end when he finds a solution to the problem, it means, he has created or developed a software. That software is the intellectual property and will become goods if put on a medium for sale.

49. The easiest way to protect intellectual property is to keep it in one's head. If a person possesses in his head a good idea, there is no risk that any one will see or find it, and thereby appropriate it. Such intellectual property may be preserved thus until its owner chooses to divulge it. If the idea consists of a process of doing some thing, it even remains securely in the possession of its owner if he performs that process when no one sees him performing. The possessor of such property can take it to the grave with him, safe in the knowledge that no one will inherit it. There is relatively little potential for the commercial exploitation of intellectual property while it remains in his head. This is because the keeping of an idea to oneself and the commercial utilisation of that idea are inherently contradictory notions. The acquirer of an intellectual property right can derive no financial benefit from it except by using it commercially. He will gain advantage only by making a product and selling it or by charging others who wish to exploit his intellect. When he offers his services or intellect to an employer, he is not selling any intellectual property as none exists on the date of contract of employment. The employer gets a right to exploit the intellect, according to his needs and requirements and he pays for the services rendered. He is not purchasing any intellectual property for the purpose of exploiting the same, as none exists on the date of contract of employment. When an employer hires technicians and pays them salary, a relationship of employer and employee comes into existence. The employer may utilise the services of the technicians for his personal use. He may also lend their services to others, who are in need of them. He may also employ them in the job he has undertaken to execute. In all these cases the technicians are rendering their service by applying their intellect. They are paid for the services rendered. In consideration of the remuneration received they are not selling any intellectual property to any one. They are not in the business of sale of intellectual property. Similarly their employer is also not in the business of sale of any intellectual property. On the other hand they are in the business of rendering service to develop intellectual property or software. Therefore, there is no element of sale involved at any stage of the transaction. The intellectual property developed by the technician in the course of employment and the intellectual property developed in the course of executing service contract does not belong to the technician or the employer. From the inception of the contract,

it is the property exclusively belonging to the customer. It is in the nature of an unbranded software. It is client specific. It may be of no use to others. It is not bought and sold in the market. It has no distinctive name or character. It is not known as a commodity in the market. The terms of the agreement between the parties give no indication of a sale or purchase of this software. On the contrary in the entire agreement what is agreed upon is providing the service.

50. In the light of the aforesaid discussion, the finding recorded by the assessing authority that the contract in question involves a sale of software development by the assessee cannot be sustained. It is contrary to the material on record, the constitutional provisions and the law declared by the Apex Court. Accordingly it is hereby set aside.

(emphasis supplied)

16 It is clear from the agreement that on the date appellant and QAD entered into an agreement there were no goods in existence. The agreement is not for transfer of software. The agreement is for appellant to provide its manpower to render services for maintenance and support to QAD. Even before (assuming appellant has developed a software) the software comes into existence, appellant has given up all the rights and claims of the software to be developed and has expressly agreed that such a software, which may come into existence, is absolute property of QAD. The consideration paid is not for transfer of any goods but is calculated at US \$ 4200 per person per month for all categories of appellant's employees. Appellant was to provide a team of 9 personnel for resolving problem reports in the form of service requests or incidents, necessitating modification of the standard product of MFG/PRO as per QAD development

standards.

17 *Mastek Limited* (Supra) relied upon by the Tribunal is not applicable to the facts and circumstances of the case. In the case of *Mastek Limited* (Supra), Mastek was required to use its professional intelligence to solution the requirements of HDFC for its Home Loan Applications; evolve a software programme to meet the requirement of the HDFC and encode a programme on its medium. HDFC's source codes were shared, unlike in appellant's case, to do the required alteration and modification to develop a programme which will meet functional requirement of HDFC. The software programme so developed was owned by Mastek and was then subsequently sold to HDFC through a medium. Hence there was clearly a sale in this case.

Even the judgments in the matter of *Direction Software Solutions V/s. Income Tax Officer*¹³ and *ISBC Consultancy Services Ltd. V/s. Deputy Commissioner of Income Tax*¹⁴ relied upon by the Tribunal are not applicable to the facts and circumstances of the case. The reliance by the Tribunal on these two decisions is totally misplaced. These were cases where the assessee(s) contended that they had developed software and were entitled to a deduction in terms of Section 10A of the Income Tax Act, 1961 which defined "computer software" to mean *inter alia* any customised electronic data or any product or service of any similar nature which is

13 (2009) 28 SOT 35 (MUM) (URO)

14 2002 (8) TMI 840 – ITAT MUMBAI

Gauri Gaekwad

transmitted or exported from India to any place outside India by any means. This gives an artificial and extremely broad definition of computer software which cannot be applied in the present case as there is no dispute that download of software is not liable to VAT. In other words, software that is transmitted over the internet is not subject to VAT. These judgments, therefore, could not have been relied upon by the Tribunal in the context of VAT.

18 Appellant is engaged merely in providing repair/maintenance and bug fixing services. While undertaking these services, appellant does not make any changes to the source code nor it has any access towards the same. Further, the codes embedded by appellant within the base software is only for bug fixing and maintenance are intended merely to let the ERP software function efficiently as it was designed and originally intended. The codes so embedded are not proprietary and do not having any marketability of their own. It does not upgrade or creates any new module/new version of the software *per se*.

An ERP Software is an integrated management software to manage core business processes. ERP is a company's proprietary system sold by the developing vendor. Third Parties like appellant come into picture just to provide Annual Maintenance Contract (AMC) and bug fixing services to let the ERP function properly and hassle free. While providing these

services, the source codes remain intact. It does not tantamount to development of new version of the software. The activity performed by appellant is essentially for providing manpower on hire and does not entail any value for assignment or transfer of any new or upgraded software. This is also evident from the invoicing under by appellant for the period under considerations.

19 It has been clarified by appellant that other activities captured side agreement development of Just in Time Sequencing Product or development of any other OAD product was never undertaken by appellant. The Karnataka Appellate Tribunal in *IBM India Private Limited, Bangalore* (Supra) when discussing levy of VAT by activity performed by ERP Implementation Specialists noted that the codes which such Professionals insert in that software are not proprietary codes, having a marketability of their own which the concerned customer can possess or transfer or sell. In other words, there is no marketable commodity in existence to be sold and unless such commodity, whether tangible or intangible, exists there cannot be a sale or a works contract. This aspect was summarily dismissed by the Tribunal and the proprietary nature of the ERP software was not duly considered.

The case at hand is also similar to the one dealt by the Hon'ble High Court of Karnataka in the case of *Sasken Communication Technologies*

Ltd. (Supra). The Tribunal distinguished this judgment on the ground that in this particular case, the ownership vested with the customer from the very inception. A true and proper reading of Clause 4 of appellant's agreement with QAD India, it would be absolutely clear that from the very inception all property is owned by QAD India and vests with QAD India. No doubt that at the end of the day, the software, which is developed is embedded on the material object that exclusively belong to QAD. In the entire contract there is nothing to indicate that appellant after developing any software has to embed the same on a material object and then deliver the same to the customer so as to affect title to the project which is developed. The title in any case, always lived and vested with QAD. There is no software that is purchased by appellant from the market. On the contrary, the agreement clearly discloses that appellant's technicians work at that office and find solutions, and, if at the end of the day, any software emerges, the same is not embedded on any medium that is capable of being bought and sold. In any event, at no time does the software become the property of appellant. In fact, even before the software comes into existence, it was the property of QAD. The Tribunal has horribly misread this clause and the order is erroneous and deserves to be set aside.

20 Intellectual property comprises of all those things, which emanate from the exercise of the human brain, such as ideas, inventions,

patents, designs etc. Intellectual property means the legal rights which maybe asserted in respect of a product of human intellect. The fruits of intellect would exist even if they enjoyed no legal protection. Intellect is not the property by itself. It is intellectual property which will become goods once put on a medium for sale. Intellectual property does not exist in the mind of the technician. What exists in his mind is the intellect and using that intellect the technician can create or develop goods. It is those goods which is the intellectual property when put on a medium for sale. The technician uses his intellect to develop intellectual property, but, the software, which is the intellectual property will become goods only if its has been put on a medium for sale. In the present case, there is no saleable medium as the work has been carried out on the original software itself which exists only the US servers of QAD. As stated above, even if there were no bugs reported during a month, QAD would be liable to pay appellant under the agreement at the rate of US \$ 4200 per month. This itself shows that this was not a contract of sale but was a contract for service.

The pith and substance of the contract or true nature of the transaction shows that the contract is a contract for service simplicitor and is not a works contract or composite contract consisting of 2 contracts - one for service and one for sale, but is an indivisible contract for service only. On examination of the contract as a whole, it becomes obvious that the contract is essentially an agreement to render service. The theory of works

contract or the concept of aspect theory is not attracted.

21 In the circumstances, the questions of law as framed by this Court on 8th December 2015 are answered in favour of appellant. The agreement dated 1st January 2006 between appellant and QAD is a contract of service and would not be a contract for sale as defined under Section 2(24) of the MVAT Act.

22 Appeal disposed accordingly.

23 No order as to costs.

(DR. NEELA GOKHALE, J.)

(K. R. SHRIRAM, J.)