Commr.Of Income Tax-V,New Delhi vs M/S Oracle Software India Ltd on 13 January, 2010

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Bench: Surinder Singh Nijjar, H.L. Dattu, S. H. Kapadia

RE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

C.A.No.235/2010 @ SLP(C) No. 4719/2008

Commr. of Income Tax-V, New Delhi ... Appellant(s)

versus

M/s. Oracle Software India Ltd. ... Respondent(s)

with

C.A.No.238/2010 @ SLP(C) No.5143/2009
C.A.No.239/2010 @ SLP(C) No.6847/2008

J U D G M E N T

S.H. KAPADIA, J.

1. Leave granted.

2. A short question which arises for determination in this batch of civil appeals is whether the process by which a blank Compact Disc (CD) is transformed into software loaded disc constitutes "manufacture or processing of goods" in terms of Section 80IA(1) read with Section 80IA(12)(b), as it stood then, of the Income Tax Act, 1961?

3. For the sake of convenience, we may refer to bare facts mentioned in Civil Appeal @ SLP (C) No. 6847 of 2008. In this appeal, we are concerned with the Assessment Years 1995-96 and 1996-97.

4. Assessee is 100% subsidiary of Oracle Corporation, USA. It is incorporated with the object of developing, designing, improving, producing, marketing, distributing, buying, selling and importing of computers softwares. Assessee is entitled to sub-licence the software developed by Oracle Corporation, USA. Assessee imports Master Media of the software from Oracle Corporation, USA which is duplicated on blank discs, packed and sold in the market along with relevant brouchers.

Assessee pays a lump-sum amount to Oracle Corporation, USA for the import of Master Media. In addition thereto, assessee also pays royalty at the rate of 30% of the price of the licensed product. The only right which the assessee has is to replicate or duplicate the software. They do not have any right to vary, amend or make value addition to the software embedded in the Master Media. According to the assessee, it uses machinery to convert blank CDs into recorded CDs which along with other processes become a Software Kit. According to the assessee, it is the blank CD in the present case which constitutes raw-material. According to the assessee, Master Media cannot be conveyed as it is. In order to sub-licence, a copy thereof has to be made and it is the making of this copy which constitutes manufacture or processing of goods in terms of Section 80IA and consequently assessee is entitled to deduction under that Section. On the other hand, according to the Department, in the process of copying, there is no element of manufacture or processing of goods. According to the Department, since the software on the Master Media and the software on the recorded media remains unchanged, there is no manufacture or processing of goods involved in the activity of copying or duplicating, hence, the assessee was not entitled to deduction under Section 80IA. According to the Department, when the Master Media is made from what is lodged into the computer, it is a clone of the software in the computer and if one compares the contents of the Master Media with what is there in the computer/ data bank, there is no difference, hence, according to the Department, there is no change in the use, character or name of the CDs even after the impugned process is undertaken by the assessee.

5. Before answering the controversy, we need to reproduce relevant provisions of Sections 80IA(1), 80IA(12)(b) as also Explanation to Section 33B of the Income Tax Act in the following terms:

> "80IA - Deduction in respect of profits and gains from industrial undertakings, etc.in certain cases.
>
> (1) Where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking or a hotel or operation of a ship (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to the percentage specified in sub-section (5) and for such number of assessment years as is specified in sub-

section (6).

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(12)    For the purposes of this section, -
(a)     ***             ***
(b)     "industrial   undertaking"  shall   have the
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meaning assigned to it in the Explanation to Section 33B;"

> Explanation to Section 33B "Explanation: In this section, "industrial undertaking" means any undertaking which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining."

6. Section 80IA occurs in Chapter VIA which deals with Deductions in respect of certain Incomes. Where the gross total income of an assessee includes any profits derived from any business of an industrial undertaking to which Section 80IA applies, there shall in accordance with and subject to the provisions of Section 80IA, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to a specified percentage for such number of assessment years as specified in Section 80IA. For deciding the present controversy, it would be sufficient to notice that the gross total income of an assessee must include profits derived from any business (eligible) of an industrial undertaking which in terms of Section 80IA(12)(b) is given the same meaning as is assigned to that expression vide Explanation to Section 33B. As can be seen from the Explanation to Section 33B, an industrial undertaking inter alia has been defined to mean any undertaking which is engaged inter alia in the manufacture or processing of goods.

7. At the outset, we may state that Section 80IA comes in Chapter VIA. That Chapter, in a way, is a code by itself. It provides for special deductions. Broadly, these special deductions are incentives provided for setting up industrial undertakings in backward areas, for earning profits in foreign exchange, for setting up hotels, etc. It is in this background that one has to interpret the meaning of the expression "manufacture or processing of goods". One more aspect needs to be highlighted. Technological advancement in computer science makes knowledge as of today obsolete tomorrow. We need to move with the times. At the same time, one needs to take note of the fact that unlimited deductions are not permissible under Chapter VIA. Therefore, in each case, where an issue of this nature arises for determination, the Department should study the actual process undertaken by the assessee. Duplication can certainly take place at home, however, one needs to draw a line between duplication done at home and commercial duplication. Even a pirated copy of a CD is a duplication but that does not mean that commercial duplication as is undertaken in this case should be compared with home duplication which may result in pirated copy of a CD. The point to be noted by the Department in each of such cases is to study the actual process undertaken by the licensee who claims deduction under Section 80IA of the Income Tax Act, 1961. At this stage, we may clarify that in this case we are concerned with the Income Tax Act, 1961, as it stood during the relevant Assessment Years.

8. From the details of Oracle Applications, we find that the software on the Master Media is an application software. It is not an operating software. It is not a system software. It can be categorized into Product Line Applications, Application Solutions and Industry Applications. A commercial duplication process involves four steps. For the said process of commercial duplication, one requires Master Media, fully operational computer, CD Blaster Machine (a commercial device used for replication from Master Media), blank/ unrecorded Compact Disc also known as recordable media and printing software / labels. The Master Media is subjected to a validation and checking process by software engineers by installing and rechecking the integrity of the Master Media with the help of the software installed in the fully operational computer. After such validation and

checking of the Master Media, the same is inserted in a machine which is called as the CD Blaster and a virtual image of the software in the Master Media is thereafter created in its internal storage device. This virtual image is utilized to replicate the software on the recordable media.

9. What is virtual image? It is an image that is stored in computer memory but it is too large to be shown on the screen. Therefore, scrolling and panning are used to bring the unseen portions of the image into view. [See Microsoft Computer Dictionary, Fifth Edition, page 553] According to the same Dictionary, burning is a process involved in writing of a data electronically into a programmable read only memory (PROM) chip by using a special programming device known as a PROM programmer, PROM blower, or PROM blaster. [See Pages 64, 77 of Microsoft Computer Dictionary, Fifth Edition]

10. In our view, if one examines the above process in the light of the details given hereinabove, commercial duplication cannot be compared to home duplication. Complex technical nuances are required to be kept in mind while deciding issues of the present nature. The term "manufacture" implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the above process. If an operation/ process renders a commodity or article fit for use for which it is otherwise not fit, the operation/ process falls within the meaning of the word "manufacture". Applying the above test to the facts of the present case, we are of the view that, in the present case, the assessee has undertaken an operation which renders a blank CD fit for use for which it was otherwise not fit. The blank CD is an input. By the duplicating process undertaken by the assessee, the recordable media which is unfit for any specific use gets converted into the programme which is embedded in the Master Media and, thus, blank CD gets converted into recorded CD by the afore-stated intricate process. The duplicating process changes the basic character of a blank CD, dedicating it to a specific use. Without such processing, blank CDs would be unfit for their intended purpose. Therefore, processing of blank CDs, dedicating them to a specific use, constitutes a manufacture in terms of Section 80IA(12)(b) read with Section 33B of the Income Tax Act.

11. One of the arguments advanced on behalf of the Department is that since the software on the Master Media and the software on the pre-recorded media is the same, there is no manufacture because the end product is not different from the original product. We find no merit in this argument. Firstly, as stated above, the input in this case is blank disc. Secondly, the test applied by the Department may not be relevant in the context of computer technology. One of the questions which arose for determination before this Court in the case of Tata Consultancy Services v. State of Andhra Pradesh, 137 STC 620 was whether a software programme put in media for transferring or marketing is "goods" under Section 2(h) of the Andhra Pradesh General Sales Tax Act, 1957. It was held that a software programme may consist of commands which enable the computer to perform a designated task. The copyright in the programme may remain with the originator of the programme. But, the moment copies are made and marketed, they become goods. It was held that even an intellectual property, once put on to a media, whether it will be in the form of computer discs or cassettes and marketed, it becomes goods. It was further held that there is no difference between a sale of a software programme on a CD/ Floppy from a sale of music on a cassette/ CD. In all such

cases the intellectual property is incorporated on a media for purposes of transfer and, therefore, the software and the media cannot be split up. It was further held, in that judgment, that even though the intellectual process is embodied in a media, the logic or the intelligence of the programme remains an intangible property. It was further held that when one buys a software programme, one buys not the original but a copy. It was further held that it is the duplicate copy which is read into the buyer's computer and copied on memory device. [See Pages 630 and 631 of the said judgment] If one reads the judgment in Tata Consultancy Services (supra), it becomes clear that the intelligence/ logic (contents) of a programme do not change. They remain the same, be it in the original or in the copy. The Department needs to take into account the ground realities of the business and sometimes over-simplified tests create confusion, particularly, in modern times when technology grows each day. To say, that contents of the original and the copy are the same and, therefore, there is manufacture would not be a correct proposition. What one needs to examine in each case is the process undertaken by the assessee. Our judgment is confined strictly to the process impugned in the present case. It is for this reason that the American Courts in such cases have evolved a new test to determine as to what constitutes manufacture. They have laid down the test which states that if a process renders a commodity or article fit for use which otherwise is not fit, the operation falls within the letter and spirit of manufacture. [See United States v. International Paint Co. reported in 35 C.C.P.A. 87, C.A.D. 76]

12. Before concluding, we may once again refer to the judgment of this Court in Tata Consultancy Services (supra) in which as stated above, it has been held that there is no difference between a sale of software programme on a CD/ Floppy and a sale of music on a CD/ Cassette. Therefore, in our view, the judgment of this Court in the case of Gramophone Co. of India Ltd. v. Collector of Customs, Calcutta, 114 ELT 770 would apply. In that case, the question which arose for determination was whether recording of audio cassettes on duplicating music system amounts to manufacture. The answer was in the affirmative. It was held that a blank audio cassette is distinct and different from a pre-recorded audio cassette and the two have different use and name. Applying that test to the facts of the present case, we hold that a blank CD is different and distinct from a pre-recorded CD. In Gramophone Co. of India Ltd. (supra), it was held that an input/ raw-material in the above process is a blank audio cassette. It was further held that recording of an audio cassette on duplicating music system amounts to manufacture because blank audio cassette is distinct and different from pre-recorded audio cassette and the two have different uses and names. In our view, the High Court was right in coming to the conclusion that the judgment of this Court in Gramophone Co. of India Ltd. (supra) is squarely applicable to the facts of the present case. We may add that in the case of Tata Consultancy Services (supra), as stated above, it has been held that a software programme may consist of commands which enable the computer to perform designated task, but, the moment copies are made and marketed, they become goods. Therefore, applying the above judgment to the facts of the present case, we are of the view that marketed copies are goods and if they are goods then the process by which they become goods would certainly fall within the ambit of Section 80IA(12)(b) read with Section 33B because an industrial undertaking has been defined in Section 33B to cover manufacture or processing of goods.

13. For the afore-stated reasons, we find no merit in the Civil Appeals filed by the Department, which are accordingly dismissed with no order as to costs.

.....J. (S. H. Kapadia) .....J. (H.L. Dattu) .....J. (Surinder Singh Nijjar) New Delhi;

January 13, 2010.