Collector of Central Excise Vs. Sunray Computers (P) Ltd.

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Court : Customs Excise and Service Tax Appellate Tribunal CESTAT Delhi

Decided On : Dec-17-1987

Reported in : (1989)(22)ECC362

Appellant : Collector of Central Excise

Respondent : Sunray Computers (P) Ltd.

Judgement :

1. The respondents manufacture and sell computers. The dispute in this appeal of the department is whether - should form a part of the value of the computers for purposes of assessment of central excise duty under Section 4 of the Central Excises and Salt Act, 2. The dispute pertains to 5 price-lists of 1983. The respondents filed these price-lists in Part II, separate for each contract of sale. The purchase order itself was Annexed to the price lists and it disclosed the goods and the services to be supplied and the charges therefor.

When we saw the price-lists, we found that they were stamped with an un-dated approval endorsement by the Assistant Collector. A doubt arose in our mind whether after having approved the price-lists, net of the software and service charges, the Assistant Collector could re-open the assessment on his own. The learned representative of the department then explained that the sequence of events was not so. He stated that as soon as the respondents filed the price lists, the valuation dispute started. The then Assistant Collector immediately issued a show cause notice proposing to include the charges for the software and the services which were a part of the same consolidated contract. On adjudication, the

Assistant Collector relying on the Supreme Court judgment in the case of Bombay Tyres International Limited [1983 ELT 1896 (SC)], held that the supply of software and services promoted the marketability of the computers and hence the charges for software and the services could not be excluded from the assessable value of the computer. The respondents went in appeal and the Collector (Appeals) held that supply of software and services had no nexus with the manufacture and sale of computers and hence the charges for the software and the services could not be included in the assessable value of the computers. It was after the passing of this order-in-appeal, favourable to the respondents, that the successor Assistant Collector then holding charge approved the price lists net of the cost of software and services. The department was now in appeal before this Tribunal with the prayer that the impugend order-in-appeal may be set aside and the order of the Assistant Collector may be restored.

3. We have heard both sides and have given the matter our earnest consideration. The relevant paragraph of the aforesaid Supreme Court judgment in the case of Bombay Tyres International Limited reads as under :- "49. We shall now examine the claim. It is apparent that for the purpose of determining the 'value', broadly speaking both the old Section 4(a) and the new Section 4(1)(a) speak of the price for sale in the course of wholesale trade of an article for delivery at the time and place of removal, namely, the factory gate. Where the price contemplated under the old Section 4(a) or under the new Section 4(1)(a) is not ascertainable, the price is determined under the old Section 4(b) or the new Section 4(1)(b). Now the price of an article is related to its value (using this term in a genral sense), and into that value have poured several components, including those which have enriched its value and given to the article its marketability in the trade. Therefore, the expenses incurred on account of the several factors which have contributed to its value upto the date of sale, which apparently would be the date of delivery, are liable to be included. Consequently, where the sale is effected at the factory gate, expenses incurred by the assessee upto the date of delivery on account of storage charges, outward handling charges, interest on inventories (stock carried by the manufacturer after clearance), charges for other services after delivery to the buyer, namely after sales service and marketing and selling organisation expenses including advertisement expenses cannot be deducted. It will be noted that

advertisement expenses marketing and selling organisation expenses and after sales service promoted the marketability of the article and enter into its value in the trade." The scope of this paragraph has been further clarified by the Supreme Court in their later judgment in the case of M/s. MRF Limited - [1987 (27) ELT 553 (SC)] according to which all costs incurred for manufacturing and marketing of the goods upto the stage of delivery at the factory gate have been held to be includible while expenses incurred after removal of the goods from the factory gate have been held to be not includible in the assessab'e value. Reading the two judgments together, it is not possible to say that each and every service activity has no nexus with the manufacture of the goods, their marketability and their delivery at the factory gate. Atleast, two types of service activities come to our mind which have a clear nexus as above. These are :- (a) pre-manufacturing research, planning and designing; these are directly connected with the manufacture of the goods and form a part of the manufacturing cost; (b) activities which may not be necessary for bringing the goods into existence but without which it would not be possible to market the goods at all. Examples of such activities are - (i) advertisement and publicity by the manufacturer to create product awareness and demand for his goods; and (ii) free warranty service for a certain period by the manufacturer to create the required impression of reliability and good quality of his products. Without these two activities, the goods can neither be manufactured nor can they be successfully marketed. The charges for such activities are, therefore, rightly includible in the assessable value of the goods for their delivery at the factory gate.

4. Since, however, excise is basically a tax on goods and not on services, the cost of any services having no nexus with the manufacturing or marketability of the goods would not be includible.

But if there is a single contract for supply of the goods as well as services, care may have to be taken to see that there is no attempt at diverting a part of the true price of the goods to service charges.

5. In the light of these general principles, we shall now deal with the individual items of dispute in this case : The nature of the technical consultancy given by the respondents to their customer is not clear from the record. We have already stated

in paragraph 3 above that pre-manufacturing research, planning and designing are a part of the manufacturing activity itself and their cost would form a cost of the machine produced. Therefore, if the service rendered by the respondents was for assessing the specific needs of a particular customer so that a computer could be tailor made for him, the cost of service would form a part of the assessable value of that computer. The respondents stated before us during the hearing that they were manufacturing and marketing only standards units and not custom made units and that their technical consultancy fee was for assessing "how the system is to be used in the particular customer's environment". The precise meaning of this statement was not clear to us nor could the learned Chartered Accountant representing the respondents explain it further in more specific terms. We direct the Assistant Collector to verify the nature of the technical consultancy provided by the respondents in each case. If it was in the nature of advice as to how the customer could utilise the computer so as to take maximum benefit out of it and it had no connection with the designing of the equipment supplied, the service or the advice as such would not be taxable nor its value includible in the value of the computer. But any goods supplied as a part of the consultancy service would be taxable on their own merits.

The training may be prior to the delivery of the computer or after it but in either case it can be said to have no nexus with the manufacture or marketability of the computer. However, as already stated in connection with the consultancy service, if any goods are supplied as a part of the training, the goods would be taxable on their own merits.

(3) INSTALLATION AND COMMISSIONING OF THE COMPUTER AT THE CUSTOMER'S PREMISES : These are clearly post-removal expenses and this activity has no nexus with manufacturing and marketability of the computer. Their cost is, therefore, not includible in the assessable value of the computer.

It is not possible to market any costly machinery article without the manufacturer extending free warranty service for a reasonable period of time. The customer needs a miniumum assurance that the machine he is buying would give reliable operation or some reasonable period and, in case of need, the manufacturer

would attend to the defect free of cost.

The cost of such after-sale-service during the warranty period is generally included in the sale price of the machine. If it is not so included already and is recovered by the manufacturer separately, it would yet be includible in the assessable value of the machine.

The machines may require servicing and maintenance even after the expiry of the warranty period. Even during the warranty period, the need for certain repairs or replacements may arise which may not be covered by the terms of the warranty, such as damage or defect occurring to the machine because of some accident. The manufacturer and his buyers may find worthwhile to enter into service arrangements in such situations also. These would be clearly post-removal expenses not connected with the manufacture or marketability of the machines. In the case of computers, certain buyers may require some special type of services, such as assistance of the manufacturer's experts for recruiting skilled labour to operate the computer and its peripheral devices. Some customer may require specific on-site programming to be done in their premises. These activities also are not connected with manufacture and marketability of the computers and are provided by the manufacturers or specialised consultancy companies on optional basis.

The charges for such services are not includible in the assessable value. However, here too, if any goods are cleared from the manufacturer's factory in pursuance of the services required, the goods would naturally be assessble on their own merits.

(i) Before starting discussion on this point, it would be worthwhile noticing the wording of Central Excise Tariff Item 33DD. It reads as under :- "Computers (including central processing units and peripheral devices), all sorts." (ii) The respondents' point is that only hardware part of the computer is goods and hence that part alone is chargeable to excise duty, that software is nothing but computer language, programme and knowledge or instruction on how to use the hardware and that language or knowledge are not goods and hence not taxable; they are only a service activity and charges therefor are not includible in the assessable

value.

(iii) We find that the aforesaid contention of the respondents is an over-simplification to the point of being incorrect. The learned representative of the department produced before us a book titled "COMPUTERS FOR EVERYBODY", 3rd Edition, by Jerry Willis and Merl Miller. This book has been written for a layman's understanding. We reproduce a couple of extract from it to facilitate understanding of what is hardware and software :- "Hardware, the actual computer and its accessories, is only half a computer system. To get it to do anything useful the computer must be given a set of instructions that will it exactly what to do.

These instructions are called programs or software and they are at least as important as the nuts and bolts of a system." "A computer is only a dumb box with a bunch of electronics in it.

All the talk about the marvelous things computer can do is really only talk about all the marvelous things software can do." (iv) The software may be language or knowledge, no doubt. But it is not passed by word of mouth. It is recorded on a medium such as floppy, cartridge, chip, diskette or documents. These recorded mediums are 'goods' in their own right, just as an education film, a langauge teaching casette tape or a music record is. They are bought and sold in the market as a valuable commodity. Their intrinsic value includes the cost of the blank medium as well as of the instruction or knowledge recorded thereon. There cannot, therefore, be any doubt that the recorded mediums are goods in their own right.

(v) Without software, the hardware is incomplete, a mere "dumb box", and of no use at all to the customer. Hardware, software and peripherals together make a workable computer. All three of them are, therefore, a part and parcel of the computer. If there is a single contract for the supply of 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 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.

(vi) Once a complete computer system has been delivered to the customer, the customer can yet need supply of software later on just as a user of a motor-car would require spares throughout the life period of a car. If there is a separate contract for supply of the software alone, the goods, through the medium of which the software is delivered, would have to be assessed on their own merit under the appropriate tariff item unless otherwise exempt from duty. If the supply of software involves only a service activity, and no goods are delivered at all, such as in a situation where an expert of the seller goes to the premises of the buyer, does the necessary research and programming and keys the programme directly into the memory of the customer's computer, it being purely a service activity and there being no goods, the question of charge of central excise duty would not arise.

(vii) When we talk of the cost of software, supplied in the shape of goods, it would, just as in the case of hardware, include the cost of warranty on the software as well.

(viii) The respondents made a point that their programme was tailor made for each customer. We do not think it makes any difference whether the goods are mass produced or are custom made. In both cases, so long as they are goods, they would have to be charged to duty, unless otherwise exempt.

6. The learned representative of the department expressed the apprehension that in a situation where a part of the costs were to be excluded, there could be a tendency to inflate the value of the excludible items and depress the value of the includible items. We can only say that verification and determination of actual expenses relating to a particular item is the job of the officer charged with the function of approving the assessable values. The answer to the apprehension expressed by the learned representative of the department does not lie with us. It is for the department to suitably instruct and guide the assessing officers. We would like, however, to make one observation in this respect. It is regarding allowing a reasonable margin of profit even for the service activity. A businessman, whether he is a manufacturer or only a consultant rendering service, exists for earning profit. Therefore, when the expenses on account of purely service items are determined, the amount should not be restricted to bare costs

only but a reasonable margin of profit for the service activity also should be added. The principle applies equally to determination of the costs of includible items.

7. Both the lower orders are modified in the light of our above discussion. The Assistant Collector is directed to determine the assessable values in accordance with our orders in the preceding paragraphs after due verification.