

**AUTHORITY FOR ADVANCE RULINGS
(CENTRAL EXCISE, CUSTOMS AND SERVICE TAX)
HOTEL SAMRAT, 4TH FLOOR, KAUTILYA MARG, CHANAKYAPURI
NEW DELHI**

PRESENT:

**Dr. Justice Arijit Pasayat (Chairperson)
Shri Y.G.Parande(Member)**

The 2nd September , 2013

Ruling No. AAR/ ST/ 04/2013

In

Application No. AAR/44/ST/09/2012

Applicant : **M/s Microsoft Corporation (India) Private Ltd.,**
9th Floor, Tower – A, DLF Cyber Green,
DLF Cyber City, Phase – III, Sector – 25A,
Gurgaon - 122002

Commissioner
Concerned : **The Commissioner of Service Tax,**
17-B, I.A.E.A. House, Mahatma Gandhi Marg,
I.P.Estate, New Delhi – 110002

Present for the Applicant : Shri Prakash Shah, Advocate

Present for the Commissioner: Shri Pramod Kumar, Commissioner (AR)

Ruling

(Dr. Justice Arijit Pasayat, Chairman)

Seeking advance ruling on issues relating to applicability of Service-tax,
the present application has been filed in terms of Section 96C of the Finance Act
1994 (herein after referred to as the "Act").

The applicant is a wholly owned subsidiary of Microsoft Corporation, USA. The issues relate to the proposed transactions of the applicant of selling/distributing standard off- the- shelf software and non-customized software products in India. The manufacture of the software products and programme membership kits has been outsourced by the applicant to third party job workers (TPJW) situated outside India. The applicant proposes to sell/distribute the software products in India to:

- a) Authorized distributors who in turn will sell them to channel partners or end users; and
- b) Industrial, commercial, institutional or similar users who would purchase them directly from the applicant.

For these purposes, the applicant will be granted non-exclusive rights to manufacture, replicate, license and sell these products by Microsoft Corporation's affiliate company and the applicant would be making royalty payments for the exploitation of these rights, calculated as a proportion of the sales revenues.

The applicant has sought ruling on a number of questions which relate to the applicability of service tax as well as customs duties in relation to their activities. The present ruling is applicable only to the questions relating to service tax. The questions relating to customs are the subject matter of a separate application. The questions in respect of service tax for which advance ruling is sought are as follows:-

Question 1 – relating to Fully Packaged Products (FPP) model
1A – Software on media

Q. (1A.3) Whether the domestic transfer of software on media would be liable to service tax in India or not?

Q. (1 A.4) Whether the royalty paid by the applicant would be subject to service tax under the Negative List based regime w.e.f. 1 July 2012, under the reverse charge mechanism?

Q. (1A.5) Whether the charges paid to TPJW located overseas, for manufacture of licensed Microsoft Products would be liable to service tax under reverse charge mechanism in India or not?

1B – Games on media

Q. (1B.3) Whether the domestic transfer of games on media would be liable to service tax in India

Q. (1B.4) Whether the royalty paid by the applicant would be subject to service tax under the negative list regime w.e.f. 1 July 2012 under the reverse charge mechanism?

Q. (1B.5) Whether the charges paid to TPJW located overseas, for the manufacture of licensed Microsoft products would be liable to service tax under the reverse charge mechanism in India?

1C – Product Key Cards (PKC) and Windows Anytime Upgrades (WAU) and similar products

Q. (1C.4) Whether the domestic transfer of PKC/WPU in India would be tantamount to providing service and be accordingly liable to service tax?

Q. (1C.5) Whether the royalty paid by the applicant would be subject to service tax under the Negative List based Approach to Taxation of Services ('Negative List regime') w.e.f. 1 July 2012, under the reverse charge mechanism?

Q. (1C.6) Whether the charges paid to TPJW located overseas, for the manufacture of licensed Microsoft products would be liable to service tax under the reverse charge mechanism in India?

1D – Client Access Licenses (CALs)

Q. (1D.4) Whether the domestic transfer of CALs in India would be tantamount to providing service and be accordingly liable to service tax?

Q. (1D.5) Whether the royalty paid by the applicant would be subject to service tax under the Negative List based Approach to Taxation of Services ('Negative List regime') w.e.f. 1 July 2012, under the reverse charge mechanism?

Q. (1D.6) Whether the charges paid to TPJW located overseas, for the manufacture of licensed Microsoft products would be liable to service tax under the reverse charge mechanism in India?

Question 2 – relating to Volume Licensing (VL) model

Q. 2.5 Whether the electronic download of software for a consideration will qualify as service (when there is no physical supply of software on media) and be liable to service tax?

Q. 2.6 Whether the domestic transfer of software licenses, both physically and electronically, would be tantamount to providing service and be accordingly liable to service tax?

Q. 2.7 Whether the domestic transfer of billable VL media would be liable to service tax?

Q.2.8 Whether the royalty paid by the applicant would be subject to service tax under the Negative List regime w.e.f. 1 July 2012, under the reverse charge mechanism?

Q. 2.9 Whether the charges paid to TPJW located overseas, for the manufacture of licensed Microsoft products would be liable to service tax under the reverse charge mechanism in India?

Question 3 – relating to loyalty programs

Q. 3.4 Whether the transactions under the loyalty programme would be tantamount to providing service and accordingly be liable to service tax?

Q. 3.5 Whether the royalty paid by the applicant would be subject to service tax under the Negative List regime w.e.f. 1 July 2012?

Q.3.6 Whether the charges paid to TPJW located overseas, for the manufacture of licensed Microsoft products would be liable to service tax under the reverse charge mechanism in India?

The applicant's stand and the Revenue's response can be summarised ad seriatim. Before doing so, a brief reference to the factual details highlighted by the applicant in respect of the proposed business model needs to be noted.

The technical details necessary for answering the questions are as follows:

1. The FPP model covers:

A. Software on media:

It is meant for single user/three users/retail consumers;

License and media come together in a packaged box i.e. as shrink wrapped software;

Software on media includes Microsoft retail software like Windows and Office.

A variant of this is the PKC/WAU wherein the retail customer electronically downloads/activates the software that is already preloaded in his computer and the packaged product contains the activation keys.

B. Games on media

These are meant for retail consumers.

License and media come together in a packaged box i.e. as shrink wrapped software.

PC games work on Automatic Data Processing machines such as Personal computer, laptops while Xbox games are meant only for use on Xbox consoles.

C. CAL:

This is a variant of FPP wherein license for a specified number of users/devices for typically Server products for which the customer would have obtained the software separately. It is meant for enterprise consumers.

2. Volume Licensing (VL) Model:

This is meant for organizations having multiple users (5 or more).

Licenses are generally delivered electronically. Price is generally charged on a per license/user basis, and it may be invoiced/collected outright, or in installments over a specific period (generally 3 years).

The software is provided electronically or on media. If the media is provided, it may be free of cost/at a nominal price, and delivered separately from the licenses, depending on customer's media request; VL model has variations such as Open License program, Enterprise and Select Plus License program, Open Value License program, Campus and School Academic License programs etc.

3. Loyalty Programs :

These are subscription based programs meant for Microsoft partners/developers etc. and provided for a limited time period.

They are meant for specific target audience such as IT developers, trainers, professionals, partners etc. who are/want to be affiliated with/certified by Microsoft;

Loyalty programs have variations such as Microsoft Partner Network (MPN), Microsoft Software Development Network (MSDN), Microsoft Action Package Software (MAPS), TECHNET, Microsoft Certified Trainers (MCT) and Microsoft Certified Professional (MCP) etc.

It will be seen that following are the common issues relating to the FPP model which includes software on media and games on media:

- (a) Applicability of Service Tax on Domestic Transfer of software/games on media.

- (b) Applicability of service tax on royalty payable by applicant under the Negative List regime w.e.f. 1 July 2012.
- (c) Applicability of service tax on charges paid to TPJW by the applicant under reverse charge mechanism.

In relation to these issues, the applicant's version is as follows:

- (a) The transfer of software/games on media which is meant for off-the-shelf purchases in retail segment, does not tantamount to provision of service in India, and accordingly, service tax is not leviable.
- (b) The payment of 'royalty' for an activity of giving rights to manufacture, replicate, license and sell the Microsoft software may be considered as a consideration for providing a 'service' under the negative list regime and hence liable to service tax.
- (c) Manufacture of goods falls under the negative list. Further, under Rule 4 of the Place of Provision of Service Rules, 2012 ('PPS Rules'), it is specifically provided that in case of services provided in respect of goods that are required to be made physically available by the recipient of service to the provider of service, or to a person acting on behalf of the provider of the service, in order to provide the service, the place of provision of service shall be the location where the services are performed. In the instant case, the rights to manufacture will be provided by the applicant to the TPJW outside India. Further, the TPJW may use CDs and other materials

and other materials for manufacturing the software based on specifications provided by applicant. Thus, Rule 4 will apply to this transaction and the place of provision of service will be the place where the services are performed i.e. outside India. Accordingly, there should be no service tax implications under the reverse charge mechanism on the charges paid by the applicant to TPJW.

The response of Revenue in respect of the aforesaid contentions of the applicant is as follows:

- (a) The domestic transfer of software on media comes under the purview of manufacture as held by the Hon'ble Supreme Court in the case of CIT-V vs. M/s. Oracle Software India Limited, C.A.No.235/2010. Therefore, the activity is not covered within the ambit of Service Tax.
- (b) The royalty paid by the Applicant is very much taxable under the reverse charge mechanism.
- (c) The TPJW located overseas are going to manufacture software on media on behalf of the Applicant and under negative list regime w.e.f. 01.07.2012, manufacture of goods itself comes under the negative list. Further, under Rule 4 of the Place of Provision of Service Rules, 2012, in case service provided in respect of goods that are required to be made physically available by the recipient of the service to

the provider of the service or to a person acting on behalf of the provider of service, in order to provide the service, the PPS shall be the location where the services are performed.

Thus so far as software and games on media are concerned the stand of the applicant and the Revenue is the same.

So far as PKC/WAU and CAL are concerned the issues are as follows:

- (a) Applicability of Service tax on Domestic transfer
- (b) Applicability of service tax on royalty payable by applicant under the Negative List regime w.e.f. 1st July, 2012.
- (c) Applicability of service charge on charges paid to TPJW by the applicant under reverse charge mechanism.

It is the stand of the applicant that

- (a) Service tax is leviable as the same qualifies as a service
- (b) Service tax is leviable
- (c) Service tax is not leviable.

For the aforesaid purpose, the stand, in respect of “Software/games on media” is reiterated.

The response of the Revenue is as follows:

Supply of PKC and WAU are “service” as held by the Hon’ble Supreme Court in Idea Mobile Communications Ltd. Vs. CCE &C, Cochin, C.A.No. 6319/2011 and accordingly, liable to service tax. Similarly, domestic supply of CALs is incidental to the rendering of telecommunications service as held in the same case i.e. Idea

Mobile Communications Ltd Vs CCE& C, Cochin. It would accordingly be liable service tax.

It is also stated that stand taken vis-à-vis “Software on media” at para (b) and (c) are applicable.

Thus here also the stand of the applicant and the department on the issue is the same

So far as VL Model is concerned the issues are as follows:

- (a) Applicability of service tax on electronic download of software in the case of VL model.
- (b) Applicability of Service Tax on Domestic Transfer of VL software licence both under physical and electronic medium.
- (c) Applicability of service tax on domestic transfer of billable VL media
- (d) Applicability of service tax on royalty payable by applicant under the Negative List regime w.e.f. 1st July 2012.
- (e) Applicability of service tax on charges paid to TPJW by the applicant under reverse charge mechanism.

The applicant’s stand inter-alia is as follows:

- (a) Electronic download of software amounts to service and therefore, service tax is leviable
- (b) Service tax is leviable as supply of software licenses under VL programme involves provisions of service.
- (c) Service tax will not apply to transfer of billable VL media

In addition the submissions in relation to software on “Software Media” para (b) and (c) are applicable.

Responding to the aforesaid stand the Revenue has stated as follows:

- (a) Under VL, the software is to be supplied on physical media or by way of electronic download of software, which involves provision of service and hence taxable.
- (b) Applicant has granted license to run Microsoft software under the VL program and supply of software is a “service” and hence liable to service tax.
- (c) As in the case software on media, transfer of VL media will not attract service tax.

Additionally it is submitted that the submissions made for paras (b) and (c) in respect of “Software on media” are equally applicable.

The residual issues relate to “Loyalty programme”. The issues raised are as follows:

- (a) Applicability of Service tax on Loyalty programme.
- (b) Applicability of service tax on royalty payable by applicant under the Negative List regime w.e.f. 1 July 2012.
- (c) Applicability of service tax on charges paid to TPJW by applicant under reverse charge mechanism.

The applicant’s submissions in this regard are as follows:

- (a) The transaction under the “Loyalty Programs” would be tantamount to service and accordingly be liable to service tax.

(b) Service tax is leviable for reasons stated above in respect the other issues

(c) Service Tax not leviable for reasons stated above.

Additionally the responses in relation to para (b) & (c) of “Software on media” are applicable.

Responding to the aforesaid submission the Revenue has submitted as follows:

The transactions under the “Loyalty programs” which can be a part of contract between the Applicant and its foreign holding company/companies are covered under the reverse charge mechanism and are liable to service tax.

Further it is stated that the submissions in para (b) & (c) relating to “Software on media” are applicable here also.

On consideration of the rival submissions, we find that the applicant’s views on the various issues have been accepted by the Revenue to be reflecting the correct position in law.

The above being the position, the interpretation projected by the applicant needs acceptance. That being so, the questions posed are answered in terms of what has been stated above.

The application is accordingly disposed of.

Sd/-

(Y.G.Parande)
Member

Sd/-

(Dr. Justice Arijit Pasayat)
Chairman