

COMMISSIONER OF CUSTOMS, CHENNAI

v.

M/S. HEWLETT PACKARD INDIA SALES (P) LTD.

AUGUST 30, 2007

[DR. ARIJIT PASAYAT AND LOKESHWARSINGH PANTA, JJ.]

Customs Tariff Act, 1985; Headings 84.71 and 85.24 and Notification No.21/2002-Cus. Dated 1.3.2002 issued thereunder:

Classification—Import of Laptops with Hard Disc Drives—CTH 84.71 or 85.24—Assessee claiming duty exemption—Exemption Notification—Applicability of—Held: Assessee imported Laptops containing preloaded Hard Disc Drives preloaded with operating systems which control the working of the Computer—Value of Laptops depend on the operating system, which is preloaded—A preloaded operating system recorded on Hard Disc Drives is an integral part of the Laptop—Assessee not only imported Laptops but also imported Hard Disc Drives on which operating system recorded—Software is classifiable w/CTH 85.24 and Laptop is classifiable w/CTH 84.71—Hence, Revenue rightly classified the Laptops, so imported, as a Unit classifiable w/CTH 84.71 and giving the benefit of deduction for the value of software classifiable w/CTH 85.25.

Words and Phrases:

'Hard disc', 'platter' and 'software'—Meaning of.

Revenue had demanded certain amount of customs duty from the respondent-assessee by classifying the goods imported by them as Laptop liable for duty under Heading 84.71 of the First Schedule of the Customs Tariff Act and denying them benefit of exemption Notification No.21/2000-Cus.dated 1.3.2002. Assessee filed an appeal before CESTAT, the Tribunal, against the demand so raised by the Revenue, which was allowed by the Tribunal. Hence the present appeal.

The question which arose for determination in this civil appeal was as to whether the imported goods, the operating systems (software) which controls the working of the computer and which is preloaded in the laptop (notebook),

A is classifiable as a separate entity under CTH 85.24 at 'nil' rate of duty or as an integral part of the laptop under CTH 84.71 at the appropriate rate of duty.

Allowing the appeal, the Court

B HELD: 1.1. The Revenue has classified the laptop as a machine under CTH 84.71 of the Customs Tariff Act, 1985 and has demanded duty on the assessable value determined by deducting the software value from the total value of the laptop whereas the assessee has classified the software loaded Hard Disk Drive under CTH 85.24 separately from the laptop and has claimed the benefit of Notification No.21/2002-Cus dated 1.3.2002.

C [Para 7] [647-A]

D 1.2. The assessee imported laptops containing preloaded Hard Disc Drives (HDD). The said drives were preloaded with operating systems (software) which controls the working of the computer. The value of the laptop depends on the operating system, which is preloaded. The computer cannot open without the operating system. [Para 9] [648-D]

E 1.3. It may be clarified that the operating system can also be imported as a packaged software which is like an accessory and which is classified by the Revenue under CTH 85.24. However, a preloaded operating system recorded on HDD is an integral part of the laptop (unit).

[Para 9] [648-E]

F 1.4. A laptop is a stand alone unit classifiable under CTH 84.71. A laptop is a small portable Personal Computer. It runs either on battery or electricity. Laptop has a screen and a small key board. [Para 9] [648-F]

G 1.5. The preloaded operating system recorded in HDD in the laptop, the imported item, forms an integral part of the laptop. What was imported in the present case was a laptop as a stand alone item (unit). Present dispute relates to the transaction value of the unit. An importer who buys a laptop containing an operating system pays for the laptop as a unit. Without the operating system, the laptop cannot work. The computer cannot open without operating system. The respondent has not only imported laptops, it has also imported HDDs on which the operating system was recorded (packaged software) which has been classified by the Revenue under CTH 85.24. However, when a laptop is imported with in-built preloaded operating system recorded on HDD the said item forms an integral part of the laptop (computer

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system) and in which case the Revenue is right in treating the laptop as one single unit imported by the assessee. The Revenue has rightly classified the laptop as a unit under CTH 84.71. [Para 10] [648-G; 649-A, B]

2. Revenue has rightly taken the value of the laptop as a unit and it has given the deduction for the value of the software. There is no error in the computation, particularly, when the assessee has refused to give the value of the software to the adjudicating authority despite being called upon to do so. The imported laptops were classifiable under CTH 84.71 whereas operating software recorded on HDD imported as packaged software were classifiable under CTH 85.24. [Paras 11 an 12] [649-C, D, E]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 5854 of 2006.

From the Final Order No. 441/2006 dated 26.05.2006 of the Customs, Excise and Service Tax Appellate Tribunal, South Zonal Bench at Chennai in Appeal Nos. C/PD/34/2006 and C/46/2006.

Vikas Singh, ASG, K. Radhakrishnan, Binu Tamta and B. Krishna Prasad for the Appellant.

V. Lakshmikumaran, Alok Yadav and M.P. Devanath for the Respondent.

The Judgment of the Court was delivered by

DR. ARIJIT PASAYAT, J. 1. Challenge in this appeal is to the order passed by the Customs Excise and Service Tax Appellate Tribunal, South Zonal Bench, Chennai (in short 'CESTAT') allowing the appeal filed by the respondent. By the impugned judgment CESTAT held that the Software-loaded Hard Discs are classifiable under Heading 85.24 of the First Schedule to Customs Tariff Act, 1985 (in short 'Tariff Act'). It was further held that respondent will be eligible for duty exemption under Notification No.21/2002-Cus as amended. It was held that rest of the machine would be classified under Heading 84.71.

2. Background facts in a nutshell are as follows:

The Department had demanded customs duty of about Rs.5.9 crores from the respondent by classifying goods imported by them under Heading 84.71 of the First Schedule of the Act and denying them benefit of exemption Notification No.21/2000-Cus. dated 1.3.2002 (as amended). Demand was questioned before CESTAT. An application seeking waiver of pre-deposit and

- A stay of recovery in respect of this amount of duty was filed. After examining the records and hearing both sides, CESTAT found *prima facie* case for the assessee in view of the Tribunal's decision in the case of *Barber Ship Management (I) Pvt. Ltd. v. Commissioner*, (2000) 117 ELT 456 (Tri.) as well as the decision in the assessee's own case reported in 2005 (126) ECR 124 (Tri-Del) and, accordingly, CESTAT have dispensed with pre-deposit of the duty amount. Further, having heard both sides at length and having regard to the high stake involved in the case, the appeal was taken up for final disposal.

- The respondents are engaged in the manufacture of, and trading in, computers including Laptops (otherwise called 'Notebooks') falling under Heading 84.71 of the CTA Schedule. They imported Notebooks (Laptops) with Hard Disc Drivers (Hard Discs, for short) preloaded with Operating Software like Windows XP, XP Home etc. These computers were also accompanied by separate Compact Discs (CDs) containing the same software, which were intended to be used in the event of Hard Disc failure. The Bills of Entry filed by the importer declared the value of Laptop and the value of Software separately, the software value including the Hard Disc value also. The Bills of Entry classified the Software-loaded Hard Discs under Heading 85.24 of the CTA Schedule and claimed exemption in terms of Sl. No.157 of Notification No.21/2002-Cus. *ibid.* These Bills of Entry were filed with the Chennai Air Customs Authorities in July 2005. Long before this, by a letter dated 7.10.2003 the respondents had informed the Addl. Commissioner of Customs, Chennai that they would be filing Bills of Entry for separate assessment of Computers and Software-loaded Hard Discs in view of the Tribunal's decision in *Barber Ship Management's* case (*supra*). It was also informed that they would claim duty exemption under Sl. No.157 of Notification No.21/2002-Cus. *ibid.* Subsequently, under cover of letter dated 11.10.2003, the respondents had also supplied to the Addl. Commissioner the OEM pricelist for the various models of 'Notebooks' imported by them. They had also provided a worksheet indicating separately the value of Hard Disc, value of Operating Software and the CD & replicating charges.

- In the meantime, at Delhi, they had imported Laptop computers with Hard Discs preloaded with Software and claimed classification of the Software-loaded Hard Disc Drives under Heading 85.24. The department issued a show-cause notice for demanding duty on these goods in terms of Heading 84.71. This demand was confirmed by the original authority, against which appeal before the Commissioner (Appeals) was preferred, who sustained the decision of the lower authority. But the appeal preferred to the Tribunal was allowed

and it was held that the Hard Disc Drives preloaded with software required to be assessed separately in terms of 85.24 of the CTA Schedule by virtue of Note 6 to Chapter 85 of the said Schedule vide Final order No.380/2005-NB-A dated 11.10.2004 reported in 2005 (126) ECR 124 (Tri-Del).

However, the Appraising Officer at Chennai Air Customs, dealing with the goods in question, queried the respondents as to why the value of the Hard Discs should not be included in the value of the 'Notebooks' for the purpose of assessment under Heading 84.71. The respondents replied by pointing out that, in terms of the Tribunal's decision in *Barber Ship Management's* case (supra) which had been upheld by this Court as reported in 2002 (144) ELT A293, the Software-loaded Hard Discs could only be classified under Heading 85.24. They also cited, in support of their stand, Final Order No.380/2005-NB-A dated 11.10.2004 (supra) passed by the Tribunal in their own case. Their arguments, however, did not weigh with the assessing authority, which proceeded to assess the Bills of Entry on a provisional basis. The jurisdictional Asst. Commissioner of Customs, after hearing the party and considering their submissions, found Hard Disc as integral part of Notebook-computer and accordingly passed Order-in-Original dated 31.10.2005 classifying the Notebooks together with the Hard Discs assembled therein, under Heading 84.71 as 'automatic data processing machines'. This order was upheld by the Commissioner (Appeals) as per Order-in-Appeal dated 25.11.2005. It is on the basis of the appellate Commissioner's order that the assessments were finalized. Hence the demand of duty which is on the assessable value comprising the value of the Notebook computers with Hard Discs excluding the value of Software. Appeals were preferred against the appellate Commissioner's order.

3. Stand of respondent before the Tribunal revolved round decision in *Barber Ship Management's* case (supra) which was affirmed by this Court in [202 (144) ELT A 293]. It was pointed out that, in their own case involving import of similar goods at Delhi, the Tribunal had classified Software-loaded Hard Disc Drives under Heading 85.24. It was argued that the issue arising in this case had already been conclusively decided by this Court in the case of *Barber Ship Management's* case (supra) and, therefore, there was nothing further to be examined in this case. It was submitted that Software-loaded Hard Disc, being "recorded media for sound or other similarly recorded phenomena...excluding products of Chapter 37" was to be classified under Heading 85.24. The department had no objection to classifying Software-recorded Hard Disc Drive, if imported without any other apparatus, under Heading 85.24. Hence the lower authorities should have been taken the aid

A of Note 6 to Chapter 85 for classifying the Software-loaded Hard Disc Drives under heading 85.24. Reference was also made to the HSN Notes under Heading 85.24. It was submitted that the authorities below had failed to note the clear distinction between Computer and Software despite decisions of this Court on the point. In this connection, reference was made to this Court's judgment in *CCE v. PSI Data Systems*, (1989) 39 ELT 692 and *Commissioner v. Acer India Ltd.*, (2004) 172 ELT 289. The ratio of the Supreme Court's decision in the case of *Sprint RPG India Ltd. v. Commissioner*, (2000) 116 ELT 6 SC was wrongly applied to the facts of the case by the lower appellate authority.

C 4. While issuing notice this Court noted that the matter appeared to be covered by 3-Judge Bench's decision of this Court in *Commissioner of Central Excise, Pondicherry v. ACER India Ltd.*, [2004] 8 SCC 173. But it was contended by learned Additional Solicitor General that the question whether Hard Discs fitted to the Computer would be treated as a Software was not specifically dealt with in the said case. Notice was issued and the matter was listed for D final hearing.

E 5. A short question which arises for determination in this civil appeal is : Whether operating systems (software) which controls the working of the computer and which is preloaded in the laptop (notebook) is classifiable as a separate entity under CTH 85.24 at 'nil' rate of duty or as an integral part of the laptop under CTH 84.71 at the appropriate rate of duty.

6. To answer the above question CTH 85.24 and CTH 84.71 need to be quoted:

CTH 85.24:

F "Media recorded with sound or similar recording, whether or not presented together with the apparatus for which they are intended or assembled with constituent parts of machines of heading 84.69 to 84.72 (e.g. disc packs) are in all cases to be classified in this heading."

G CTH 84.71

"Automatic data processing machines and units thereof; magnetic or optical reader, machines for transcribing data on to data media in coded form and machines for processing such data, not elsewhere specified or included."

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7. The Department has classified the laptop as a machine in CTH 84.71 and has demanded duty on the assessable value determined by deducting the software value from the total value of the laptop whereas the assessee has classified the software loaded Hard Disk Drive (for short, 'HDD') under CTH 85.24 separately from the laptop and has claimed the benefit of Notification No.21/2002-Cus dated 1.3.2002.

8. To answer the above controversy meaning of the words software, hard disk and platter need to be noted (See: Computer Dictionary by Microsoft - Fifth Edition at pp.489, 246 and 408 respectively):

"Hard disk. A device containing one or more inflexible platters coated with material in which data can be recorded magnetically, together with their read/write heads, the head-positioning mechanism, and the spindly motor in a sealed case that protects against outside contaminants. The protected environment allows the head to fly 10 to 25 millionths of an inch above the surface of a platter rotating typically at 3600 to 7200 rpm; therefore, much more data can be stored and accessed much more quickly than on a floppy disk. Most hard disks contain from two to eight platters. See the illustration. Also called: hard disk drive.

Hard disk drive n. See hard disk

Platter. One of the individual metal data storage disks within a hard disk drive. Most hard disks have from two to eight platters. See the illustration. See also hard disk.

Software. Computer programs; instructions that make hardware work. Two main types of software are system software (operating systems), which controls the workings of the computer, and applications, such as word processing programs, spreadsheets, and databases, which perform the tasks for which people use computers. Two additional categories, which are neither system nor application software but contain elements of both, are network software, which enables groups of computers to communicate, and language software, which provides programmers with the tools they need to write programs. In addition to these task-based categories, several types of software are described based on their method of distribution. These include packaged software (canned programs), sold primarily through retail outlets; freeware and public domain software, which are distributed free of charge; shareware,

A which is also distributed free of charge; although users are requested to pay a small registration fee for continued use of the program; and vaporware, software that is announced by a company or individuals but either never makes it to market or is very late. See also application, canned software, freeware, network software, operating system, shareware, system software, vaporware, Compare firmware, hardware, liveware.”

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9. On the basis of the above dictionary meanings it becomes clear that a software is a computer programme. It consists of instructions that make hardware work. There are two types of softwares, namely, system software which controls the working of the computer and application software such as word processing programmes, databases etc., which perform the tasks for which we use computers. In addition, we now have network software which enables groups of computers to communicate, and language software which provides programmers with the tools with which they write programmes. We also have what is called as packaged softwares which are sold through retail outlets. In the present case, the respondent imported laptops containing preloaded HDD. The said drives were preloaded with operating systems (software) which, as stated above, controls the working of the computer. The value of the laptop depends on the operating system, which is preloaded. The computer cannot open without the operating system. The laptop without an operating system is like an empty building. At this stage, it may be clarified that the operating system can also be imported as a packaged software which is like an accessory and which in the present case is classified by the department under CTH 85.24. However, a preloaded operating system recorded on HDD is an integral part of the laptop (unit). Such preloaded operating system on the HDD forms an integral part of the laptop. It is important to note that laptop as a stand alone unit is classifiable under CTH 84.71. A laptop is a small portable Personal Computer (in short 'PC'). It runs either on battery or electricity. Laptop has a screen and a small key board. Most of the laptops run on the same software as their desk top counterparts. Most of the laptops accept floppy disks, CD ROM Drives, External or Internal Modem etc. A notebook computer is a laptop. It is a machine. A CD or a floppy disk is a peripheral.

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10. Applying the above tests to the facts of the present case, we are of the view that preloaded operating system recorded in HDD in the laptop (which is the item of import) forms an integral part of the laptop. What was imported in the present case was a laptop as a stand alone item (unit). Present

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dispute relates to the transaction value of the unit. An importer who buys a laptop containing an operating system pays for the laptop as a unit. As stated above, without the operating system, like Windows, the laptop cannot work. The computer cannot open without operating system. In the present case, the respondent has not only imported laptops, it has also imported HDDs on which the operating system was recorded (packaged software) which has been classified by the Department under CTH 85.24. However, when a laptop is imported with in-built preloaded operating system recorded on HDD the said item forms an integral part of the laptop (computer system) and in which case the Department is right in treating the laptop as one single unit imported by the respondent. The Department has rightly classified the laptop as a unit under CTH 84.71, quoted above.

11. Before concluding it may be pointed out that in none of the decisions cited on behalf of the respondent, the question raised in the present dispute was ever raised. Although laptop is similar PC, the former is more compact. It cannot be assembled as easily as PC. In the present case, the Department has rightly taken the value of the laptop as a unit and it has given the deduction for the value of the software. There is no error in the computation, particularly, when the respondent has refused to give the value of the software to the adjudicating authority despite being called upon to do so.

12. For the afore-stated reasons, we are of the view that the imported laptops were classifiable under CTH 84.71 whereas operating software recorded on HDD imported as packaged software were classifiable under CTH 85.24 and accordingly Civil Appeal filed by the Department deserves to be allowed, and the impugned judgment of the Tribunal is set aside. There will be no order as to costs.

S.K.S.

Appeals allowed.