THE COMMERCIAL BANK OF CEYLON
v
THE DIRECTOR GENERAL OF CUSTOMS AND OTHERS

COURT OF APPEAL
TILAKAWARDENA, J. (P/CA) AND
WIJEYARATNE, J.
CA NO. 218/2001
AUGUST 26, 2002
DECEMBER 9, 2002 AND
JANUARY 23, 2003

Customs Ordinance, No. 17 of 1869, sections 8 (1), 9, 10, 51 and 167 – Amending Act, No. 2 of 2003 – Applicability of section 10 to software installed in the computer system on a licensing agreement – Computation of the value – Sale of Goods Ordinance , sections 2 (1) and 2(3) – Is there a sale or purchase of goods? – Code of Intellectual Property Law, No. 52 of 1979, sections 13, 44, 81 and 117 – What is a copyright? – Does it exclude goods? – Revenue Protection Act, No. 19 of 1962, section 2 – Imposition of customs duty – Applicable law.

The petitioner, a licensed Commercial Bank entered into a licensing agreement to use information by way of software programs. The respondent alleged that the software installed in the petitioner's computer system has been imported on several tapes and C.D's through courier service without payment of GST and other statutory dues.

The petitioner contended that the software programs do not fall within section 10 and therefore duties cannot be levied.

The respondent contended that the value that has to be placed upon the goods has to be considered as a value added to the carrier medium, *viz.*, diskettes and disks on which the software was imported into the country and the carrier medium has a value added factor due to the additional material that had been imported due to the value of the software that was contained therein.

Held :

(i) The term goods, wares and medium disk have not been defined in the Customs Ordinance. Schedule A referred to in section 10 comprised of groups of commodities in the rate of duties prescribed for each commodity. Customs Authority could levy duty in terms of section 10 only upon such goods, wares and merchandise identified in Schedule "A".

(ii) On a perusal of Schedule E – section 10 it is clear that in terms of the Harmonising Code of the HS Code that software is not identified as goods, wares or mechandise.

(iii) Clause 1 of Schedule E is the umbrella provision, which refer to the value of goods as the value which would fetch at the time of importation on a sale in the open market. The petitioner has obtained only the right to use software through the licensing Agreement with "X" Ltd., There is no outright purchase or sale of the software material – Clause 2: 8: 2 of Schedule E is therefore not applicable.

(iv) Under the licencing agreement the provider retained the ownership of the software and only the right to use the software was granted by the licencing agreement, to the petitioner

(v) The contention that, when goods are valued – clause 2:9:2 – Schedule E – if they are imported under a foreign copyright the value of this right to use the copyright should also be included in the normal use, cannot be accepted. The Brussels definition of value does not refer to the right to use a copyright. Patents, designs and trademarks are all related to products, whereas copyright is related to intellectual creations. The copyright Law protects only the form of expression of ideas and not the ideas themselves. Copyright is excluded from the definition of goods.

Per Shiranee Tilakawardena, J., (P/CA)

"Off the shelf and customised software sold outright to a user are subject to tax in the full value. In Licence Customs Software Package imported as intangible personnel property on' a licencing fee should be valued on the basis of a carrier medium only. The Licence Customs Software being intangible personal property be excluded from the value of duty and payments for software programs stored on the carrier Medium could only be valued on the career medium. In summarising the value of computer software that is imported on flexible diskettes can be distinguished between the value of the software program and the diskette that carries the software (career media). The career media will always affect the Customs duty.

(vi) The Petitioner is using customised software tailor made for the use of the petitioner Bank only and such would not attract Customs duty.

APPLICATION for a *writ of certiorari.*

Cases referred to:

1. *Controller General of Customs* v *Lego Australia Partilim (Pvt) Ltd.*, (1997 - 329 FCA (6.5-1997).
2. *Deputy Minister of National Revenue* v *Mattel Canada INC* (2001) - 2 SLR 100

3. *Elitunnel Merchanting Ltd.*, v *Regional Collector of Customs* 2000 - NZ CA 270 (12.4.2000)

Mohan Pieris with *T. Dharmawardena* for petitioner.

C.R. de Silva, P.C. Additional Solicitor-General with *Sajeewa Samaranayake* for Attorney-General.

Cur.adv.vult

July 08, 2003

SHIRANEE TILAKAWARDENA J. (P/CA)

The petitioner is a licensed commercial bank within the meaning of the Banking Act No. 30 of 1988 as amended. The business activities of all licensed commercial banks are regulated and monitored by the Central Bank of Sri Lanka.

In order to improve the services afforded to the customers, the petitioner bank had entered into a licensing agreement to use information by way of software programs. On 13th June 2000 the petitioner had received a letter from the Assistant Director General of Customs alleging that the application software installed in the petitioner's computer system has been imported on several tapes and CD's through courier service without payment of GST and other statutory levies. Petitioner had made an application No. 692/00 to the Court of Appeal and while the application was pending, the respondent served a notice summoning the petitioner for an inquiry under section 8 of the Customs Ordinance.

On 15.01.2001, the petitioner has made an application in the aforesaid application seeking interim order staying the said inquiry. There the 1st and the 2nd respondents had taken the position that the said application relates to an order made in terms of section 9 of the Customs Ordinance, but the interim order sought by the petitioner was in relation to an order made in terms of section 8 (1) of the Customs Ordinance. However, according to the directions given by the Court of Appeal on 15.01.2001 the said inquiry was adjourned.

Another notice dated 29.01.2001. was sent by the 2nd respondent summoning petitioner to attend an inquiry on 08.02.2001 and the objections raised by the petitioners were overruled by the 2nd respondent. Therefore petitioner has filed this application praying for a *writ of certiorari* quashing the said decision summoning the petitioner for an inquiry and the decision made on 08.02.2001 overruling the objections raised by the petitioner. Further petitioner seeks a writ of prohibition restraining the respondents from proceeding with the said inquiry.

The only issue that has to be decided in this case is whether the software programs fall within the purview of Section 10 of the Customs Ordinance insomuch as whether it includes "goods, wares and merchandise" for the purpose of levying duties thereunder.

Section 10 of the Customs Ordinance deals with the levying of customs duty on goods imported into Sri Lanka and this Section reads as follows:

> "The several duties of customs, as the same are respectively inserted, described, and set forth in figures in the table of duties (Schedule A) shall be levied and paid upon all goods, wares and merchandise imported into or exported from Sri Lanka".

The term 'goods, wares and merchandise' has not been defined in the Customs Ordinance. Schedule 'A' referred to in this section comprised of groups of commodities or items in the rate of duties prescribed for each such commodity or item. This Schedule 'A' is based on an International Convention on the Harmonized Commodity Description and Coding System commonly referred to as the HS Code, which fact is considered by both parties. Accordingly the Customs Authority could levy duty in terms of section 10 of the Customs Ordinance only upon such goods, wares and merchandise that had been identified by Schedule A of the Customs Ordinance. The respondents' contention is that the value that has to be placed upon the goods has to be considered as a value added to the carrier medium, namely the diskettes or disks on which the software was imported into the country. That the carrier medium, had a value added factor due to the additional material that had been imported due to the value of the software that was contained therein. In this regard it is important to peruse section 51 and the related provisions of the Customs Ordinance which deals with the valuation of goods for the

purpose of imposing custom duties.

Section 51 as amended by Act, No. 83 of 1988 reads as follows:

"In all cases when the duties imposed upon the *importation of articles* are charged according to the value thereof the respective value of each such article shall be stated in the entry together with the description and quantity of the same, and duly affirmed by declaration by the importer or his agent, and such value shall be determined *in accordance with the provisions of Schedule E* and duties shall be paid on a value so determined".

The term "value" has been defined in section 167 which reads as follows:

"In relation to imported *goods,* whether such goods were imported lawfully, or otherwise, means the price of such goods, *as determined in accordance with Schedule E".*

Paragraph 1 of Schedule E reads as follows:

"The value of any imported goods shall be the normal price, that is to say the price which they would fetch at the time of importation on a *sale* in the *open market between a buyer and a seller* independent of each other as indicated in paragraph 2.7".

In this regard it is imperative to ascertain whether the customized software used by the petitioner forms part of a sale as envisaged in terms of the ambit of the paragraph 1 of Schedule E. On a perusal of Schedule E of Section 10 it becomes clear that in terms of the Harmonizing Code of the HS Code that software is not identified as goods, wares or merchandise. The ancillary issue that arises is whether the value of the software should be added as a value added factor in the valuation of the carrier medium, because by virtue of section 51 the duties had been levied upon an imported article on the basis of the value. The contention of the respondent is that the software transaction of the petitioner falls within the ambit of Clause 2.8.2 of Schedule E. This Clause reads as follows.

2.8.2."When goods are valued if they are imported under a foreign trade mark, the value of the right to use the patent, protected design or trade mark shall be included in the normal price. It further states that this section applies in the case of copyright or

any other intellectual property."

It is on this basis the respondent submits that software is a copyright material which comes under the purview of this Clause. However what is significant is that Clause 1 of Schedule E which is the umbrella provision refers to the value of goods as the value which would fetch at the time of importation on a *sale in the open market.* Under the present circumstances the petitioner has obtained only the right to use software through the licensing agreement with Fiserve (ASPAC) Pvt. Ltd. There is no outright purchase or sale of the software material that is the subject matter of this dispute.

In this context, the definition of the sale of goods or of section the definition of a sale contained in the Sale of Goods Ordinance section 2 (1) is relevant. This section reads as follows:

> "A contract of sale is a contract whereby the seller transfers or agrees to transfer the property in the goods to the buyer for a money consideration called "the price".
>
> Further section 2 (3) defines a sale as;
>
> "Where under a contract of sale the property in the goods is transferred from the seller to the buyer the contract is called "a sale"....."

Therefore when the petitioner obtained the right to use the software through a Licensing Agreement the provider retained the ownership of the software and only the right to use the software was granted by the Licensing Agreement. In this context, it is important to analyze the relevant features contained in the Licensing Agreement.

Under the clause "Description of the software system" it is stated that "the ACBS system, and all modifications, enhancements, upgrades and traditions, whether made by Fiserve or by client, are the sole and exclusive property of Fiserve's parent. Title to the ICBS system as well as all copyrights, trade secrets, and other rights shall remain in Fiserve's parent, and client has permission to use the ICBS system subject to the terms and conditions of the Agreement".

Also under "Limitations on use: Non-transferability" clause in the said Agreement states " The ICBS system may not be used to provide service bureau or time share services to third parties without the prior

written consent of Fiserve. This Agreement, the license and the ICBS system to which it applies may not be assigned, sublicensed or otherwise transferred by the client without prior written consent from Fiserve, which consent....."

On a perusal of these Clauses referred to above contained in Licensing Agreement makes it clear that only the right to use the Customized Software was granted to the Petitioner. Therefore this could not be termed as a "sale" adverted to in Clause 1 of Schedule E.

It is also important to consider that in Schedule E of the Ordinance the situation that was contemplated was where a price was paid for a sale. In the present situation it is a licensing fee which has been paid by the petitioner merely for the use of such software. In this context, the interpretation given by the respondent has also to be analyzed. The respondent stated that according to Clause 2.8.2 of Schedule E, software was a copyright material. Therefore when interpreting Clause 2.8.2. when goods are valued, if they are imported under a foreign copyright, the value of the right to *use the copyright should also be included* in the normal price. In this context, it is important to see whether the Brussels Definition of Value on which Schedule E is based, warrants such an interpretation. Article III of the Brussels Definition of Value reads when goods need to be valued are (a) manufactured in accordance with patented invention or goods to which any protected design has been applied; or (b) are imported under a foreign trade mark; or (c) are imported for sale, other disposal or use under a foreign trade mark, the normal price shall be determined on the assumption that it includes the value of the right to use the patent, design or trade mark in respect of the goods. It is clear that the Brussels Definition of Value does not refer to the right to use a copyright. The definition shows that the patent, design and trade mark are all related to products whereas copyright is related to intellectual creations the concept 'right to use' in relation to patents, designs and trade marks and in relation to copyright, in order to understand it one has to distinguish copyrights from other forms of intellectual rights.

The Copyright Law protects only the form of expression of ideas and not the ideas themselves. That law protects the form in which the original work was expressed by the author. Sections 44, 81 and 117 of the Code of Intellectual Property Act, No. 52 of 1979 deal with the right to use an intellectual design or patent and a trade mark. All these sections refer to the use of a product embodying either an industrial design, patent or trade mark. Section 44 (1) (b) states that the registered owner of an industrial design has the exclusive right to import of or sell or *use a product embodying* such industrial design.

Section 81 (3) (a) (i) which refers to exploitation of the patented invention refers to the act of using the product in respect of which the patent is granted. On the other hand section 13 deals with the limited number of instances where protected work can be used. It is significant to note that special concept embodied in this section is fair use of a copyright. It must be emphasized that the fair use of a work protected by copyright contemplates a totally different concept, when compared with the use of a product embodying an industrial design or use of a patented product.

David Bainbridge in Introduction to Computer Law 4th Edition at page 168 states; "Contracts for the acquisition of software alone cannot be sale of goods contracts; the title to the software is not normally transferred nor is a computer program or database a good ....." Further states that "It seems unlikely, that even if the copyright is transferred with the computer programs, that an intangible computer program resident on a magnetic disk or in a computer chip is a personal chattel (as opposed to the disk or chip), because copyright is a "thing in action" like company shares or a money order, to be contrasted with the more tangible "things in possession" such as motor cars or computers. Copyright is thus excluded from the definition of goods."

It has been the contention of the petitioner that the type of software used by the petitioner is specially made for the petitioner's particular and specific need and such software is not available in the open market. Therefore the software that was obtained by the petitioner cannot be considered as a sale of goods contract and accordingly does not fall within the ambit of Schedule E and the relevant provisions of the Customs Ordinance, especially section 10 and section

51. Accordingly the decision made by the respondents to call for information by documents dated 13.06. 2000 is ultra vires the powers granted under section 9 of the Ordinance. For the Articles related to the powers of the Director General of Customs is specifically spelt out in section 10 of Schedule A and includes only goods, wares or merchandise and precludes it being applied to the software which is the subject matter of this case. It is relevant to quote at this stage the observation made by Michel Danet, Secretary General, Customs Organization, where he has stated that "From a technical perspective, the word Customs Ordinance strongly supports the WTO declaration that imposing duties on intangible goods is not economic because Customs would have to set up a control system, which would cost more than it would generate in revenue. The question of classifying intangible goods, which have no physical equivalent, would also pose many difficulties".

The powers given in terms of section 9 of the Customs Ordinance is only to ascertain any matter relating to customs or with regard to any matter into which it is the duty of the Director General of Customs under this Ordinance. It is not the duty of the Director General of Customs to decide whether the software is taxable commodity by virtue of section 9 of the Customs Ordinance. Further, commodities subject to custom duties are identified in Schedule E to section 10 of the Ordinance. A decision which should be made under the statutory authority is only valid if it is made within the powers granted by the Statute. In this context, Wade on Administrative Law 8th Edition page 357 states as follows:

> "Statutory powers conferred for public purposes is conferred as it were upon trust, not absolutely - that is to say, it can validly be used only in the right and proper way which Parliament when conferring it is presumed to have intended".

This becomes more evident when perusing the proviso to section 10 wherein it provides "Parliament may from time to time, by means of a resolution duly passed at any public session, increase, reduce, abolish, or otherwise alter the customs duty leviable on any goods imported into or exported from Sri Lanka".

By section 2 of the Revenue Protection Act, No. 19 of 1962, there is provision for the cabinet by way of a Bill or resolution to impose any

custom duty on any article for the time being not subject to such duty. Therefore it is only the Parliament which could decide as to which article should be identified as being subject to custom duty, and it is not the duty of the Director General of Customs who has to only act in compliance of the powers given to him under the Statute and defined in terms of the Statute.

In terms of Section 51 of the Customs Ordinance, No. 17 of 1869 it is required that the value of articles imported are to be determined in accordance with Schedule E and for duties to be paid in accordance with such values. As referred to above, Schedule E in paragraph 1 states that the value of any imported goods **shall be the normal price.** Paragraph 2.8 of Schedule E specifically states that the normal price of any imported goods shall be determined on the assumption that when the goods are valued, the value of the right to use the patent, copyright etc. are included in the normal price.

Schedule E 2.8 reads:

"that when goods are valued they-

2.8.1 are manufactured in accordance with any patented invention or are goods to which any protected design has been applied; or

2.8.2 are imported under a foreign trade mark, the value of the right to use the patent, protected design or trade mark shall be included in the normal price. (This provision shall also apply in the case of copyright or any other intellectual property rights).

This system of valuation which Sri Lanka had adopted was based on the Brussels Definition of Value (BDV) adopted after Convention on the Valuation of Goods for Customs Purposes (15th of December 1950 and entered into force on the 28th of July 1953) (Customs Law of Sri Lanka 2002 by P. Weerasekera and T. Kananathalingam) which discusses the two systems of customs valuation BDV and the GATT. It is important to consider that in compiling the Brussels Definition of Value certain principles of valuation were formulated by the European Customs Union Study Group 1947 and these principles are as follows.

(1) Dutiable value should be based on equitable and simple principles which do not cut across commercial practice.

(2) The concept of dutiable value should be readily comprehensible to the importer as well as to the custom.

(3) The system of valuation should not prevent the quick clearance of goods.

(4) The system of valuation should enable traders to estimate in advance, with a reasonable degree of certainty, the value for customs purposes.

(5) The system of valuation should protect the honest importer against unfair competition arising from under valuation, fraudulent or otherwise.

(6) When the Customs consider that declared value may be incorrect the verification of essential facts to the determination of dutiable value should be speedy and accurate.

(7) Valuation should be based on the greatest possible degree on commercial documents.

(8) The system of valuation should reduce formalities to a minimum.

(9) The procedure for dealing with law suits between importers and the customs should be simple, speedy, equitable and impartial.

It is important to say that whilst this article refers to definition of "value" in Articles 1, 2 and Articles 3 the interpretative notes to the definition of value which is set out in the Addendum to Article 1 reads as follows:

"Studied groups especially recommended in a general Addendum that the concept of value expressed by the definition and the interpretative notes be employed for the value of all goods subject to customs declarations, including duty free goods and goods liable to specific customs duties. Addendum to Article 1 which is the note to be used for the Interpretation of the Definition of Value has several sub notes and reads as follows.

Addendum to Article 1

NOTE 1

The time when the duty becomes payable, referred to in paragraph (1) of Article 1, shall be determined in accordance with the legislation of each country and may be, for example, the time at which the goods declaration for home use is duly lodged or registered, the time of payment of customs duty or the time of release of the goods.

NOTE 2

The "costs, charges and expenses" mentioned in Article 1, paragraph (2) (b) include, inter alia, any of the following:

- carriage and freight;
- insurance;
- commission;
- brokerage;
- costs, charges and expenses of drawing up outside the country of importation documents incidental to the introduction of the goods into the country of importation, including consular fees;
- duties and taxes applicable outside the country of importation except those from which the goods have been exempted or have been or will be delivered by means of refund;
- costs of containers excluding those which are treated as separate articles for the purpose of levying duties of customs, cost of packing (whether for labour, materials or otherwise);
- loading charges.

NOTE 3

The normal price shall be determined on the assumption that the sale is a sale of the quantity to be valued.

NOTE 4

Where the determination of the value or of the price paid or payable depends upon factors which are expressed in a currency other than that of the country of importation, the foreign currency shall

be converted into the currency of the importing country at the official rate of exchange of that country.

NOTE 5

The object of the Definition of Value is to make it possible in all cases to calculate the duties payable on the basis of the price at which imported goods are freely available to any buyer on a sale in the open market at the port or place of introduction into the country of importation. It is a concept for general use and is applicable whether or not the goods are in fact imported under a contract of sale, and whatever the terms of that contract.

But the application of the Definition implies an inquiry into current prices at the time of valuation. In practice, when imported goods are the subject of *a bona fide* sale, the price paid or payable on that sale can generally be considered as a valid indication of the normal price mentioned in the Definition. This being so, the price paid or payable can reasonably be used as a basis for valuation, and Customs Administrations are recommended to accept it as the value of the goods in question, subject:

(a) to proper safeguards aimed at preventing evasion of duty by means of fictitious or colourable contracts or prices; and

(b) to such adjustments of that price as may be considered necessary on account of circumstances of the sale which differ from those envisaged in the Definition of Value.

Adjustment under paragraph (b) above may in particular be required with reference to freight and other expenses dealt with in paragraph (2) of Article 1 and Note 2 of the Addendum to Article 1, or with reference to discounts or other reductions in price granted in favour of sole agents or sole concessionaires, or to any abnormal discount or any other reduction from the ordinary competitive price.

Thereafter consequently on an Agreement for the Implementation of Article 7 (VII) of the General Agreement of Tariffs and Trade in 1994 the primary basis for customs value under this Agreement was defined in Article 1 as the transaction value. As a result of the World Trade Organization Valuation Agreement formally known as the agreement on the Implementation of Article 7 of the General Agreement of Tariffs and Trade 1994 (GATT) replaced the

GATT Valuation Code. As a result of the Uruguay Round Multi Lateral Trade Negotiations which created the WTO in 1994. But the Agreement established a customs valuation system that primarily based the customs value on the **transaction value** of the imported goods. It is significant and of importance to note that Sri Lanka who was an original GATT member joined the WTO on the 1st of January 1995 and thereby undertook obligations under the GATT (1994) - including the customs valuation system. This agreement provided a set of valuation rules, expanding and giving greater position to the provisions on customs valuation in the original GATT. However, Sri Lanka repeatedly delayed the passing of necessary laws in order to implement the WTO Customs Valuation Agreement in 2000 and 2001 (World Trade Organization G/VAL/N/4/LKA/1) which is a notification concerning a decision under paragraph 1 of annexure 3 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 dated 14th August 2000 and also the World Trade Organization G/VAL/N/4/LKA/1/Corr.11, a second notification concerning a decision under paragraph 1 of annexure 3 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 dated 17th August 2000.

Most importantly Sri Lanka by an Act of Parliament bearing No. 2 of 2003 amending the Customs Ordinance (Bill No. 77-2002) incorporated the GATT Customs Valuation Rules in Schedule E which provides for the customs value of imported goods to be the "transaction value" that is the price actually paid or payable for goods when sold for export. Further Article 8 (c) adds to the transaction value the royalties and licensing fees related to the goods being value which the buyer must pay as a condition of sale. In the amending Act Article 8 states that;

> Article 8.1 - "In determining the customs value under the provisions of Article 1 there shall be added to the price actually paid or payable for the imported goods ..... (c) royalties and license fees related to the goods valued that the buyer must pay, either directly or indirectly, **as a condition of sale of the goods** being valued to the extent that such royalties and fees are not included in the price actually paid or payable.

Many of the Commonwealth countries have accepted this transaction value method as is seen in many of the decisions of those

countries. In the Administrative Appeals Tribunal Decision Federal Publishing Company of Australia and Collector of Customs No. N89/695 AAT No. 5919 Customs where it was held that the customs value of the subject goods was assessed under the transaction value method and this was taken to by the Collector of Customs to be the total consideration passing under the contract of sale and it was held that the customs value of goods to be valued is the transaction value of the goods and that was the appropriate method of valuing the subject goods. In that case it was submitted that it was only one set of relevant imported goods, namely, the positive trends. Other goods existed like negative trends that they were not imported. The transaction value was held to be the price paid in relation to other services and goods. In the Federal Court of Australia also in the case of *Controller General of Customs* v *Lego Australia Partilim (Pty) Ltd,*(1) readily it had been held that the primary method was the determination of the transaction value and this was on the basis of implementation of Article VII of the General Agreement of Tariffs & Trade to which Australia was a signatory and that as far as the customs were concerned as the value having regard to the transaction value method. In the case of *Deputy Minister of National Revenue* v *Mattel Canada* (2) (Canadian case) it was held that it was a valuation method that was to be followed and it was the price paid or payable for the goods when the goods were sold for export to Canada and that the relevant sale for export is a sale by which title to the goods passes to the importer, if the royalties were not as a condition of sale, if the royalties were in the sale of contract the separate and distinct mark.. It was held that it was not within the meaning of the transaction value method in terms of their Customs Act. In the case of Court of Appeal of New Zealand "Elitunnel Merchanting Limited v The Regional Collector of Customs(3) it was decided that was the transaction value method which was relevant. It is important to mention that at this stage certain Indian cases had been cited as authorities. However it is important to note that India has specific and several Acts that deal directly with computers and software programs and these differ from State to State. Therefore such cases would be inapplicable in Sri Lanka.

Next matter to be determined by this Court is how software valuation is determined. According to the Trade Information Centre Documentation under Article VII of 1984 General Agreement on Tariffs

& Trade (GATT) it was declared that software valuation either may be inclusive or exclusive of the cost or value for the intellectual property component of the product. However it was recommended that software valuation to be based on the value or cost of the carrier medium (that is the optical) rather than the "intellectual property within" embedded in the medium. The United States maintains the practice of valuing software on the carrier medium and General Canada, Western Europe and many Asian countries also adhere to this method of valuation.

An additional consideration with software is the assessment of taxes on the product. Unlike tariffs, taxes are imposed in the United States "eg. Value added taxes imposed at the board "are always assessed on the full value of the software including intellectual property unless there is a special tax treaty with the particular country. However it has been recommended that the software valuation be based on the value or cost of the carrier medium, rather than on the intellectual property embedded on the medium. (Trade Information Centre Harmonized Tariff System (HTS) Category on GATT) and (Decisions adopted by the WTO Valuation Committee at its first Meeting on the 12 May 1995).

During the 10th Meeting held on the 24th of September 1984 the Committee on Customs Valuation re-affirmed that the transaction value was the primary basis of the transaction under the Agreement on Implementation of Article VII of the General Agreement on Tariffs & Trade. In determining the customs value of imported carrier media wherein data or instruction only the cost or value of the carrier medium itself shall be taken into account. The customs value shall not therefore include the cost or value of the data or instructions provided that this is distinguished on the cost or value of the carrier medium. In the statement made by the Chairman at the Meeting of the Committee on Customs Valuation of 24th September 1984, it was stated that if the technical facilities are available to the parties to the transaction, the software could be transmitted by wire or satellite in which case the question of custom duties does not arise. In addition the carrier medium is usually a temporary means of storing the instructions or data. In order to use it the buyer has to transfer or reproduce the data or instructions into the memory or data base of his own system. Further it was recommended that it will be consistant with the agreement if the

cost or value of the carrier medium itself in determining the customs value of imported carrier media bearing data or instructions. Many reasons can be adduced why the intellectual property component that should be excluded from the transaction value and therefore not be subject to customs duty.

(a) If facilities are available the software/intellectual property can anyway be sent through the internet or by satellite, in which case the issue of customs duties would not arise.

(b) The carrier medium is usually a temporary means of storage only.

(c) In any event, there would be taxes (VAT, Sale taxes) on the full value of the product.

(d) Internet delivery also provides for expeditious delivery to the customer.

(e) Internet delivery would also eliminate shipping and handling charges.

(f) The value of the intellectual property can be many times greater than the value of the carrier medium and the high duties could cripple business and trade.

Indeed the World Trade Organization's Information Technology Agreement was negotiated in 1996 and entered into force in 1997. It is in fact by which customs duties on information technology products can be eliminated and Sri Lanka however is not a signatory to this agreement.

However through out the Commonwealth it is the common practice a common policy has been followed. Canada Values Software on its carrier medium alone for purposes of customs duty and this is the position for sales of customs made software as is the subject matter of this case. The intellectual property is taxed with the GST and this has been set out in the Ottawa April 17th 2001 Memorandum D13 - 11-6. The guidelines and general information in determining value for duty on computer software was that the customs duty is not the basis on the value of the instructions or data content as because it was a

signatory country to the GATT Valuation Agreement.

In considering the salient matters in the present case it is important to note that it is only a copy of the computer software which is a custom defined program which has been provided under a license agreement for an initial (up front charge) within an on going fee for use. In such cases ownership and control of the software is not transferred to the receiving party. In other words, there is no sale. The license or lease fee has been paid to the owner for the right to use the software for an agreed period.

In all the circumstances of this case, it is the opinion of this Court that off the shelf and customized software sold outright to a user are subject to tax in their full value. However in License Customs Software Package imported as intangible personnel property on a licensing fee should be valued on the basis of a carrier medium only. Therefore the License Customs Software being intangible personnel property be excluded from the value of duty and payments for software programs stored on the carrier medium could only be valued on the carrier medium. In this context, carrier medium mean goods capable of storing software, whereas software or other instructions or data to be processed by data processing agreement.

The goods as far as taxation regarding to software are concerned would be the actual medium containing the software or information. For eg. the magnetite's, the disk, diskettes, compact disks (CD's) or read only "CD Videos". If the items are off the shelf or customized both determine a difference in the customs duties. In this context, "normalized" are mass produced (off the shelf which are available to all customers) and useable by them independently after installation and limited training in a standard form to carry out the same applications and functions. They are made up of a coherent set of programs and support materials and include the service of installation, training and maintenance. In summarising the value of computer software that is imported on flexible diskettes can be distinguished between the value of the software program and the diskette that carries the software (a carrier media). The carrier medium will always attract the customs duty. In the present circumstances the petitioner is using customized software tailor-made for the use of the petitioner Bank only and such would not attract customs duty.

In all the circumstances of this case therefore the application of the Petitioners is allowed and the Court issue *writs of certiorari* to quash the order summoning the petitioner for an inquiry under Customs Ordinance and the decision dated 8.2.2001 which overruled the objections raised by the petitioner at the said Inquiry. Also a Writ of Prohibition is granted restraining the respondents from taking any steps under the Customs Ordinance. No costs.

WIJEYARATNE, J. - I agree

Application allowed.