

Information Technology Software Services

By CA Madhukar N Hiregange FCA, DISA (ICAI)
& CA Sudhir V S B.com, ACA

The journey of covering all Industries into to service tax net has reached the Industry that has contributed for placing our country on the global map has been slowly being bought into the mainstream of normal tax rules and restrictions albeit on a voluntary basis. Inclusion of software in the net causes rejoice for the software exporters, on the same time is expected to face difficulty for the software service providers in complying with service tax provisions. This would be partly due to the nature of services being provided by this sector as well as the fact that "service tax" as a tax is still evolving even after 14 years of its introduction in the year 1994. The insertion of the new service category "Information Technology Software Service" as a taxable service with effect from 16.05.08 is however been an entry bought in at the behest of the industry as the government would end up with more than Rs. 6000 crores as refund payable for the year 2008-09 itself.

Prior to amendment made by Finance Act 2008, outsourced information technology services in relation to designing or developing of computer software or system networking or any other service primarily in relation to operation of computer systems had been escaping levy of service tax as there had been specific exclusion provided for the same under the category of business auxiliary service. This exemption had certain disadvantages in the sense that a service provider exporting IT services abroad in accordance with the Export of Service Rules 2005 could not go in for the benefit of refund of cenvat credits or for rebate under Rule 5 of the said Rules as the services exported were not regarded as taxable services because of the exclusion/exemption enjoyed by such services.

It is to be noted that there are various types of services being provided in the IT sector apart from software engineering services and that there is considerable confusion about the services that are taxable and the services that enjoy exemption. While software engineering might have been exempted earlier, the benefit of exemption did not extend to other services as well and these services would have to be distinguished from the core activities involved during software engineering. The services provided may include services like manpower supply, on-line information and database access or retrieval service, development and supply of content service, maintenance or repair of software, consultancy or advice in relation to software etc.

Maintenance and repair of software sold off the shelf falls under management, maintenance and repair services category by virtue of the decision of the Supreme Court in Tata Consultancy Services Vs State of Andhra Pradesh ((2004) 11 LCX 008) wherein software sold off the shelf in canned form was held to be goods and liable to sales tax as a consequence of which the term "goods" referred under management, maintenance and repair service category was clarified to include software. Consultancy or advice in relation to software that had been licensed was earlier regarded as part of software engineering and enjoyed the exclusion under consulting

engineer's service category by virtue of the decision given in SAP India Systems Applications & Products in Data Processing (P) Ltd Vs CST Bangalore ((2007) (02) LCX 356). Thus correctly classifying the services would assume significance. Further the software program or products were liable for VAT and the dividing line might be quite thin.

Information Technology Software Service - newly introduced category with effect from 16.05.08

As per Section 65(105)(zzzze) of Chapter V of Finance Act, "taxable service" means any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including -

1. Development of information technology software,
2. Study, analysis, design and programming of information technology software,
3. Adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,
4. Providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software,
5. **Acquiring the right to use information technology software for commercial exploitation including the right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,**
6. **Acquiring the right to use information technology software supplied electronically.**

As per Section 65(53a), "information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment.

Issues

Whether the acquisition of right to use canned software would be liable?

In the opinion of the paper writers, what could be taxed here is the acquisition of right in respect of customized software as the transfer

of right to use canned/standardized software would amount to transfer of right to use goods and liable under the sales tax law. This might have been inserted to tax distribution of ERP packages where there is some customization involved.

One should remember that canned/standardised software sold off the shelf is treated as "goods" as discussed earlier and subject to sales tax. Such canned software would also be subject to duty of excise where a manufacturing process is involved and finds mention under Chapter 85 of Central Excise Tariff Act 1985.

Whether the service provider who exports IT software services abroad would be eligible to opt for refund?

One advantage of the introduction of service tax levy on IT software services has been the opening up of options available for an exporter of services. The service provider exporting IT software services in accordance with the Export of Service Rules 2005 can have the option of going in for refund of the cenvat credit under Rule 5 of Cenvat Credit Rules 2004. Another alternative could be to go in for rebate of service tax paid under Rule 5 of Export of Service Rules 2005. (Note - the service has been put under the third category i.e recipient based criterion for the purpose of determining whether the service has really been exported out of India in accordance with the Export of Service Rules 2005 where the services are provided from India to a person residing abroad.)

Whether VAT can be levied on the value charged towards software engineering?

Yes. The VAT authorities can tax software engineering activity especially where the software development is undertaken by the

service provider and then the entire software which has been developed is sold as such to the customer. In this case the department can rightly contend that the same amounts to sale of goods.

But where the software development is undertaken at the request of the customer and the transfer of right over the software happens in stages on completion of the various stages or processes of the Systems Development Lifecycle, the developmental activity can also be regarded to be one of service or if property in goods is transferred a works contract which could be held taxable under both service tax as well as VAT. Here it would be pertinent to note the decision given by the Supreme Court in *Imagic Creative (P) Ltd Vs CCT ((2008) 12 STT 392)* where service tax and VAT were held to be mutually exclusive and a composite contract involving sale of goods and provision of services was distinguished from an indivisible contract. Under the VAT law, one would be entitled to claim deduction for the labour charges included in the gross amount billed. In case of works contracts one could examine opting for notification 12/2003 ST which would require quantification for value of goods or materials sold during course of providing of service. Where this is possible, deduction can be claimed for the value of such goods or materials sold, and service tax charged on the balance. Where not quantifiable, one would not have any other option but to prove that the contract is one for sale of software and that the same is indivisible and subject to levy of VAT and not service tax though this may be questioned by the service tax authorities. Whatever the stand the industry takes it maybe advisable to disclose its stand to both the State and Central tax departments.

TAX COURT

by CA PVSS.Prasad, FCA

(1) Issue not contested in one case - no bar for other cases:

If the Revenue has not appealed against a decision with a particular issue, which is not in their favour, it is not open for the Revenue to appeal another case with an identical issue. This is the settled position of Law as per cases **Union of India Vs Kaumudini Narayan Dalal (2001) 10 SCC 231**, **CIT Vs Narendra Doshi (2004) 2 SCC 801** and **CIT Vs Shiv Sagar Estates (2004) 9 SCC 420**. In view of the issue being agitated further by the Revenue, a reference was made to larger Bench for a fresh examination. It was held by the Hon'ble Apex Court, if the Revenue has not preferred an appeal against an issue in a particular case and prefer an appeal on the same issue in another case only with mala fides, the same is to be established by the Assessee. In the normal circumstances, when the Revenue has not preferred appeals in respect of a particular issue on account of policy decision like the tax involved, being meagre amounts etc., the same cannot debar the Revenue from preferring an appeal on the same issue in another case. When the just cause is established by the Revenue, it cannot be prevented from filing an appeal. Accordingly, the larger Bench gave a decision reversing the earlier position.

C.K. Gangadharan and Another Vs CIT (2008) 304 ITR61 (SC)

(2) Rectification of Orders under Sec. 254(2) - by ITAT - Time Limit:

An issue came up before the Hon'ble Supreme Court, as to whether time limit of four years for rectification of an Order of a Tribunal under Sec. 254(2) is applicable only for moving such rectification petition or is it also applicable for passing such rectification order by the Tribunal. Rajasthan High Court in **Harshavardhan Chemicals and Minerals Ltd. 256 ITR 767** held that, if the miscellaneous petition for rectification is moved by either Assessee or the Revenue under Sec. 254(2) within the stipulated time of four years, then the Tribunal is at liberty to pass the orders even after completion of such four years period. In the instance case, Madras High Court dissented with this view. Against such view the appeal was filed before the Apex court. After an elaborate review of the judicial precedence, it was held that the time limit of 4 years would be made applicable only for moving the petition either by the Assessee or the Revenue and such time limit has no application for subsequent disposal of the order by the