

Withdraw exemption given to software services

By S Sivakumar

THE IT Sector (by IT, I mean Information Technology and not Income Tax .with the 2008-09 Budget round the corner, it is perhaps important to clarify) would seem to have been getting a lot more favorable treatment from the successive Finance Ministers, as compared to other sectors comprising the services sector. Perhaps the FM thinks that software professionals are more important to the society than perhaps, Chartered Accountants or Architects or Engineers or Marketing Consultants or HR Consultants? What else would justify the exclusion of the software services sector from the reach of the ever expanding service tax net?

A look at the current service tax provisions and exemption notifications would clearly suggest that the Government has not been able to fully comprehend the various facets of the Software Services sector. Consider for instance, the fact that, the word 'software' has not been directly used in the statute, except in some Board Circulars and Notifications. Rather, the words 'Information Technology' have been defined to exclude software services.

The definition of 'Information Technology service' has undergone a major change with effect from May 1, 2006. Prior to May 1, 2006 it was defined as any service in relation to designing, developing or maintenance of Computer software, or Computerized data processing, or System networking, or any other service primarily in relation to operation of computer systems. After May 1, 2006, it is defined as any service in relation to designing, or developing of Computer software or System networking, or any other service primarily in relation to operation of computer systems. It is then clear that effective May 1, 2006, computerized data processing and maintenance of computer software and system networking shall not be treated as 'Information Technology' service under BAS and would hence be liable for service tax. However, activities like designing and developing computer software and system networking are still covered under the definition of 'Information Technology service' and not taxable by virtue of exclusion from the purview of BAS.

Taxability of software services is also connected to the definition of 'Consulting Engineer's service'. Prior to the Finance Act, 2007, taxable service in respect of 'consulting engineer' meant any service to a client, by a consulting engineer in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering; but not in the discipline of computer hardware engineering or computer software engineering. After enactment of the Finance Act, 2007 (with effect from June 1, 2007) the taxable service means any service to a client, by a 'consulting engineer' in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering including the discipline of computer hardware engineering but excluding the discipline of computer software engineering. Further, the exemption to taxable services provided by a 'consulting engineer' in relation to computer software vide Notification No. 4/99 was withdrawn with effect from September 10, 2004 making computer software related maintenance service taxable after this date.

Interestingly, a reference to software services is also noticed in terms of the Management Consultant's services. In terms of a taxable service provided in relation to Enterprise Resource Planning (ERP) software system by a 'management consultant' in connection with the management of any organization which were exempted from Sep. 10, 2004 (Notification No. 16/2004) to Feb. 28, 2006 vide Notification No. 2/2006 are taxable after Feb 28, 2006. Frankly, it beats logic to say that a Management Consultant who advises on ERP related services should be exempted from service tax, as contrasted to another who advises on other software related services. Luckily, this anomaly has now been removed.

Now, the reference to software services under both BAS and Consulting Engineer's services reflects the confusion that prevails in the Government's mind. Added to this is the confusion arising out of treatment of software products as 'goods' for purposes of levy of sales tax/ VAT. In the well known case of In case of Tata Consultancy Services v. State of Andhra Pradesh (2004-TIOL-87-SC-CT-LB), the Supreme Court, while upholding the levy of sales tax on branded software, also went on to state as follows ¶Thus, even unbranded software, when it is marketed/sold, may be goods. We, however, are not dealing with this aspect and express no opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or whether the contract is a service contract may arise".

It is common knowledge that, in software service contracts, there is delivery or transfer of right given to the client to use programs or modules which are nothing but unbranded software, per se. Irrespective of whether these unbranded software would constitute 'goods' for purpose of levy of sales tax/VAT, there can be no doubt that in all of these contracts, there is a predominant element of service which is present right through.

As the service tax law has evolved over the last few years, many components or facets of the software sector have come to be taxed. Some of these are maintenance of computer software, lending or deployment of software personnel, management consultancy services related to software, etc. Of course, the BPO sector is also subject to service tax under Business Auxiliary Services (BAS) under Section 65(19) of the Finance Act, 1994. Irrespective of the rationale behind taxing the BPO sector but exempting the software services sector, one would need to appreciate that the dividing line between the various

segments or sectors are rather thin. For instance, it is very difficult to differentiate somebody who lends software professionals and one who undertakes software services projects. It would ultimately depend on the wording of the contracts and it does no good to a taxing system which allows the determination of the levy of a tax to be based on the way the underlying contract is worded.

As contrasted to any other service segment, the IT segment constitutes the largest and the fastest growing one. With the various segments like BPO, Manpower Supply, Software Maintenance, Computer Hardware Engineering etc. being subjected to service tax, one sees little justification in the software services industry continuing to be left out. If the justification is in terms of the need to promote the software services sector, perhaps, there is a lot more justification in exempting the BPO segment and the Computer Hardware Engineering segment, which post much lesser margins and are in the danger of becoming uncompetitive, due to the appreciating rupee. Despite the raising rupee, as aforesaid, the software services sector continues to post high growth rates both in terms of business as well as, in terms of profitability. There is then no justification for treating the software services sector as a holy cow, in my opinion.

One last point.

The levy of service tax on software services could come as a blessing in disguise. Being an exempted service, software exporters, who contribute very significantly to the size of the sector, while continuing not to pay service tax under the Export of Services Rules, 2005, will now be able to claim cenvat credit in respect of the service tax paid on input services including the service tax paid on their premises, if the software services were to be made taxable services.

Levying service tax on software services might turn out to be good for the sector, after all.