Do our policy makers really understand the software industry – March 28, 2008

Do our policy makers really 'understand' the software industry?
MARCH 28, 2008
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A provocative title for an article, indeed.
We must thank the makers of our great Constitution for guaranteeing us the freedom of speech which makes it possible for us to find an appropriate title to write a piece on what seems, the Ministry's utter lack of understanding of the software industry.

TIOL has carried a lot of articles (including two from me) on the Finance Ministry's proposal to levy service tax on the software industry. The more I read the Budget and the connected notifications and clarifications, the more confused I become, (despite my association with this industry over the past 15 years or so) on what exactly the Finance Ministry is trying to do, with this promising industry, vis-à-vis its proposals on the applicable indirect taxes..

Take the case of how 'software' is treated under the central excise law. It is classified under Tariff No 85238020 under the head ' Information Technology Software' which was brought into the excise net from January 1, 2007, replacing the then existing Tariff No. 8524. Mr B V Kumar, the highly respected ex-Member of the Board, writing in TIOL, rightly called it a New Year Gift from the Finance Minister. It is, of course, ironical, that the Government sought to levy tax on 'software' thro' Notification No. 49/2006 dated 30.12.2006, which was basically an exemption notification. The fact that the Ministry used the words 'Information Technology Software' and 'Software' synonymously speaks of its confusion, to start with.

The lack of understanding on the part of the Ministry becomes clearer when one reads Notification No. 49/2006 in conjunction with the Notification No. 6/2006-CE dated 1.3.2006, which had exempted 'customized software' from the levy of excise duty. In this Notification, the Government had defined 'customized software' as 'any custom designed software developed for a specific user or client, other than packaged software or canned software'. The fact that Notification No. 49/2006 talked of 'software' falling under Tariff No. 8523 while levying excise duty while the earlier Notification No. 6/2006 talked of Tariff No. 8524 while exempting 'customized software' is a typical example of the confusion that prevailed in the Ministry's mind.

However, there is no denying the fact that the software industry indeed believed and still believes that 'customized software' is not subject to the levy of excise duty, despite efforts of the Customs Department to deem all imported software as 'packaged or canned software' for purposes of the levy of the CVD, as rightly pointed out by the respected Mr B V Kumar. Now, this Notification No. 6/2006 continues to be valid, to the best of my knowledge, post Budget.

It then becomes clear that that the Government indeed continues to think that 'customized software' is goods, despite having exempted it for the purpose of levy of excise duty. How else would the Government remove the levy of excise duty on 'customized software', unless 'customized software' is goods? After all, excise exemption is given only to goods which are otherwise chargeable to excise duty.

Against its stated position that 'customized software' is goods, eligible for exemption of excise duty by virtue of Notification No. 6/2006, the Government now does a complete 'U' turn while imposing service tax on 'Information Technology Software service'.

Here is what the Ministry says now, vis-à-vis its proposal to levy service tax on customizedsoftware.

“Software consists of carrier medium such as CD, Floppy and coded data. Softwares are categorized as “normal software” and “specific software”. Normalised software is mass market product generally available in packaged form off the shelf in retail outlets.

Specific software is tailored to the specific requirement of the customer and is known as customized software. Packaged software sold off the shelf, being treated as goods”. Netizens would be amazed to see the two diametrically opposite views that the same Finance Ministry takes, vis-à-vis customized software. For purposes of excise law, customized software is ‘goods’ for the Ministry, while for purposes of levying service tax, the same customized software is ‘services’. The confusion couldn’t have been more explicit.

Writing in TIOL earlier, I had pointed out that the Centre is trying to get into the shoes of the State Governments, vis-à-vis its proposal to levy service tax on ‘right to use software’ to right to tax which, as per Article 366(29A)(d), is reserved for the States.

By the way, there are too many ‘software’s doing the rounds, vis-à-vis the Ministry.

Packaged software, canned software and customized software under the central excise law and normal software, normalised software, specific software and customized software under the service tax law. One has really got to have an ‘abnormal’ mind to understand the ‘normal’ meaning of these terms.

The usage of so many adjectives then reflects the confused mind of the Ministry. The Ministry which is busy issuing notifications and circulars, left right and centre, for ’removal of doubts’ presumably of the industry, would do well to issue a clarificatory notification to ‘remove its own doubts’ on whether customized software is ‘goods’ or ‘services’.

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