# Indirect Taxes on packaged software – Confusion confounded Post-Budget 2010 – Oct 6, 2010

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**By S Sivakumar, CA**

**INDIA** is a world leader in software. Indian IT companies are respected and revered, the world over. The fact remains that this industry has managed to survive and grow, despite the Government, which has managed to create fresh complications and controversies thro' the Budget provisions for 2010-11, especially, as they concern the packaged software sector.

Let's take a look at how packaged software has been treated under the various indirect tax laws as of February 27, 2010, the day the new notifications were issued.

'Software' is classified under the Central Excise 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. Of course, 'Information Technology Software' includes both branded as well as, tailor made software. However, all software other than canned/packaged is 'exempt' from central excise duty/CVD under Sl. No. 27 of Notification No. 6/2006-CE, dated March 1, 2006.

In terms of the levy of customs duties, im port of Information Technology Software falling under Customs Tariff No. 85244011, whether branded or tailor made, is exempt from the levy of customs duties, in terms of Notification No. 21/2002-Cus. Dated 1.3.2002 (Sl No. 157), including what is popularly known as 'paper licenses' of software. In terms of the central excise tariff, paper licenses are covered under 49070030, with a Nil duty rate. Thus, on paper license, neither customs duty nor central excise/CVD is applicable. However, the customs authorities have been more than happy to treat all software imports as that of package software and levy CVD.

Now, in terms of the applicability of service tax on packaged software, the Government introduced Section 65(105)(zzzze) to the Finance Act, 1994, with effect from May 16, 2008, on 'Information Technology Software Services'. In terms of Sub-Sections (v) and (vi) of Section 65(105)(zzzze), the Government introduced service tax on acquiring the right to use information technology software for commercial exploitation including 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 and acquiring the right to use information technology software supplied electronically. It was clear that the electronic transfer of right packaged software through the licensing route was covered by Section 65(105)(zzze), with effect from May 16, 2008.

In terms of the levy of VAT on packaged software, licensing of packaged software is treated as goods and accordingly levied VAT under the VAT laws of the States, irrespective of whether the license was transferred electronically or physically. Most packaged software players took the view that, since VAT is levied on the transfer of licenses, service tax could not be levied. This view was also supported by the impact arising out of Notification No. 12/2003, which is still valid and which states that service tax cannot be levied on the value of the transaction representing the sale value of goods. I am not aware of any player paying central excise duty on the sale of packaged software. On the other hand, due to reasons best known to them, some players have started charging both service tax and VAT on the value of the licenses. The fact that many players are neither charging central excise duty nor service tax on licensing of packaged software has probably prompted the Government to bring issue certain Notifications on February 27, 2010, which would seem to have further complicated matters.

**Let's take a look at Notification No. 02/2010-Service Tax which reads as follows:**

The Central Government exempts the taxable service as referred to in section 65(*105*)(*zzzze*) of the Finance Act, 1994, for packaged or canned software, intended for single use and packaged, accordingly, from the whole of service tax, subject to the following conditions, namely : -

*++ the document providing the right to use such software, by whatever name called, if any, is packed along with the software;*

*++ the manufacturer, duplicator, or the person holding the copyright to software has paid the appropriate duties of excise on the entire amount received from the buyer; and*

*++ the benefit under Notification No. 17/2010-Central Excise, dated February 27, 2010 is not availed of by the manufacturer, duplicator or the person holding the copyright of the software.*

This Notification gives the impression that, central excise duty would be applicable on sale of packaged/canned software intended for multi use, while service tax is to be paid on sale of packaged/canned software for single use and packaged accordingly. Notwithstanding the legality of levying service tax/central excise duty depending on whether the license is meant for single/multi use, the fact remains that, this Notification has brought about a lot of confusion in terms of the practices followed by the software sector. For instance, it is anybody's guess as to whether, a single license for packaged software, housed in the central server of the buyer which would allow multiple users to access the software, would constitute single use or multi use. Further, the requirement that the license should be 'packed' along with the software has baffled many. What would happen when a license given along with the sale of the packaged software, gets renewed for a subsequent period, is anybody's guess, as, in this case, the license is not 'packed' along with the packaged software?

Notification No. 17/2010-CE contains another impossible requirement to be met. The Notification requires the importer to pay central excise duty on the entire amount received from his buyer. How can the hapless importer be required to pay CVD which arises at the time of the import, on the value to be received by him on the sale of the software, which is an event occurring subsequent to the import? Perhaps, the Board expects the importer to develop psychic powers, to determine in advance, the price at which he would be selling the imported software and pay CVD accordingly?

Another parallel Notification bearing No. 17/2010-CE has been issued on February 27, 2010 exempting packaged software or canned software, falling under Chapter 85 of the CE Tariff, from so much of the duty of excise leviable thereon as is equivalent to the excise duty payable on the portion of the value representing the consideration paid or payable for the licensing of the software, provided that a declaration is made in respect of such consideration and further provided that, the person providing the right to use shall be registered under the provisions of the Finance Act, 1994. One does not understand what the Government has achieved by issuing this Notification, in as much as, the Notification does not categorically state that, central excise duty is exempted so long as service tax is paid, which is perhaps what the Government had intended. For, all that Notification requires is that, the packaged software seller should be 'registered' with the Service Tax Department.

Let's also take a look at a similar notification issued under the Customs Act. In terms of Notification No. 31/2010-Customs dated February 27, 2010, imports of packaged/canned software are exempted from the levy of counterveiling duty on the value of the licenses, so long as the importer has registered himself with the Service Tax Department and has made a declaration to that effect to the Deputy/Asst Commissioner of Customs. Here again, the Government would seem to have bungled up, in as much as, the intention seems to be to exempt from CVD, packaged software imports which have suffered service tax. But the Notification only states that the importer has to register himself with the Service Tax Department. This Notification would seem to have achieved nothing as most ports and air cargo complexes are refusing to implement this Notification even after four months of its issue. The Board would do well to check this fact for itself.

There is no clarity in terms of the applicability of indirect taxes import of packaged software licenses through the Net. Can it be said that the Customs Notification No. 31/2010-Customs is applicable only for physical imports of packaged software and not to imports through the Net? I've no clue, Sir. By the way…can the

mode of import of packaged software determine its taxability under the customs/CVD laws or under the service tax law?

There have also been cases where both the Central Excise Department and the Service Tax Department have demanded duty and service tax from the packaged software players, not to talk of the harassment that importers of packaged software players undergo in the ports and air cargo complexes.

There has been so much of confusion that, nobody knows which indirect tax is applicable on packaged software, whether sold within India or imported. The confusion surrounding this industry would definitely seem to have got compounded, post the Budget 2010-11. Matters would seem to have worsened with the Madras High Court holding in the ISODA case ***(2010-TIOL-620-HC-MAD-ST)*** upholding the constitutional validity of Section 65(105)(zzzze) of the Finance Act, 1994, introduced with effect from May 16, 2008 imposing service tax on the sale/transfer of software licenses. As we have seen above, the Central Government has been kind enough to exempt the levy of service tax on packaged software, thro' Notification No. 02/2010, if central excise duty has been paid, on the license value, subject to certain conditions. Perhaps, the Board being unsure of the legality of the service tax levy, had given the 'option' to the industry to pay central excise duty in lieu of service tax, on the sale of packaged software licenses. With the Madras High Court's decision in its favour, would the Board now regret having issued this Notification bearing No. 02/2010?

**Before parting….**

Many of my professional friends have been taking a view that, since Notification Nos. 17/2010-CE and 31/2010-Customs only require the packaged software player to be registered with the Service Tax Department, exemption from central excise duty and CVD would be available, even when service tax is not paid. I cannot fault with this view, as a plain reading of the Notifications indeed suggests this, though the intent of the Government seems to be that, either of service tax or central excise duty/CVD would have to be paid by the packaged software seller/importer.

Given the fact that the Government does not know whether it should collect service tax or central excise duty/CVD on packaged software, it does seem to have left the choice to the players in the industry. The Government seems to think that so long either of these is paid, it is fair enough. But this intent, does not seem to have percolated down to the respective revenue departments, viz. Customs, Central Excise and Service Tax. As aforesaid, the Customs is not accepting the validity of Notification No. 31/2010-Customs, given the fact that all along, it had been collecting CVD on packaged software imports and is refusing to clear the import consignments without collecting CVD. This is sad state of affairs and the Board has to assume the responsibility for letting things to come to such a pass, as this.

With Mr Nandan Nilekani having shifted base to Delhi, one would have expected our Babus to improve their understanding of the software industry. Unfortunately, the Government would seem to be doing everything to add to the complexities surrounding the levy of indirect taxes on the software sector.

The current state of affairs leaves much to be desired, more so as it concerns India's most promising industry. One does not know how the Government can expect compliance, when there is an absolute lack of clarity on the applicability of the indirect tax provisions and the individual revenue departments are up against one another, in terms of levy of indirect taxes. T he packaged software industry consists of several types of players, viz. simple resellers, importers, duplicators, value added resellers, third party implementers, third parties who maintain these packages, etc. Levy of service tax or central excise duty would have to be based on the activities carried out by the players and there cannot be a straight jacket solutions fitting into all situations. Surely, the Government, driven purely by revenue considerations, cannot tell the industry either to pay central excise duty or service tax, at their sweet option. This is not good tax governance, Sir. Didn't the great Chanakya say, as far back as in 3 rd Century B.C. that t axation should not be a painful process for the people and that there should be absolute clarity in the tax structure along with reasonable rates so that people don't think of evading payment of taxes?

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