MRP-based Scheme for packaged Software Govt opens Pandora s box – Dec 26, 2010

MRP-based Scheme for Packaged Software: Govt opens Pandora's Box
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IN a quiet move, the Government has brought the entire packaged software industry under the MRP based central excise levy scheme by issuing Notifications bearing **Nos 30/2010-CE** and **53/2010-Service Tax**, both dated December 21, 2010. In terms of**Notification No 30/2010-CE**, an abatement of 15% has been given on the MRP of the packaged software, based on which, central excise duty will have to be paid by the manufacturer and CVD to be paid by the importer. Consequently, in terms of**Notification No. 53/2010-ST**, no service tax shall be payable on the license value in terms of clause (v) of Section 65(105)(zzzze) of the Finance Act, 2010.

These Notifications have major ramifications for the packaged software industry and this article is a quick attempt to understand some of these…..

Under the new dispensation, it would be pertinent to note that the MRP based valuation would be applicable only for the physical mode used for licensing of the packaged software licenses, as contrasted to the electronic mode of transfer, which is actually covered by clause (vi) of Section 65(105(zzzze) of the Finance Act, 1994. Hence, electronic transfer of licenses for packaged software would still be outside of the central excise levy and would, instead, get covered under the service tax levy.

In terms of imports of packaged software licenses, importers would now, perhaps, have the choice of either importing the licenses in the electronic mode, or in the physical mode. Till now, importers were either paying CVD on the physical imports or service tax on the electronic imports, on the transaction values and it did not matter, as the rates of service tax and CVD were the same. Now, with the MRP based valuation being implemented for CVD on physical imports, importers would be much better off, shifting to the electronic imports, as the value add margins for importers are typically in the region of 30% to 40%.

Even, the local manufacturers would find it better to shift to the electronic mode of transfer of software licenses, as paying service tax @ 10.3% on the transaction value would be cheaper as compared to paying central excise duty @ 10.3% on MRP less 15% abatement and also considering the complications of finding out the MRP.

One does not exactly understand or appreciate the very need for bringing the whole of packaged software industry under the MRP based levy, covered by Section 4A of the Central Excise Act, which, by and large, covers generic consumer goods like biscuits, chocolates, aerated water, soaps, electric fans, mobile fans, etc. By no stretch of imagination can packaged software be treated as falling under the same category of consumer goods, etc. Notwithstanding this, the abatement of 15% per se seems to be unreasonably low, given the fact that, in the case of imports, the players work with a typical trading margin of between 30% to 40%, as aforesaid.

The new dispensation could throw up a lot of practical problems, especially, for importers. In most cases, the concept of MRP does not work for imported packaged software products. Could the Customs treat the ultimate selling price charged by the importer, as the MRP, where is no MRP for the software product imported? Importers should foresee inordinate delays in clearance of their consignments, due to the new confusions that would arise.

By issuing these Notifications, the Government wants to be sending a clear signal that, packaged software is 'goods' and not 'services'. But, we must bear in mind that, the electronic transfer of software licenses being 'goods' is still a service, in terms of clause (vi) of Section 65(105)(zzzze). Hence, we would now have the situation that, while, an electronic transfer of a packaged software license would be a service, a physical transfer of the same packaged software, would be goods. Imagine the plight of a domestic player, who handles both these modes of delivery. How could the mode of delivery determine the central excise duty/CVD or service tax payable on the same product?

It would be a big mistake to assume that the entire packaged industry can be covered under the MRP regime. Except for shrink wrapped software, the MRP regime does not seem to work for the rest of the packaged software sector. A software player, holding valid IP rights, can transfer licenses to various customers, at different prices, arising out of customization, etc. without necessarily following the MRP route. How can MRP be computed on these transactions and excise duty be levied under the new dispensation?

The problem would become more complicated, when software licenses pass through multiple trading channels. Will the Department assume that the ultimate selling price charged by the last person in the channel, would be the MRP? And, how can a manufacturer know the ultimate selling price of his product license and accordingly pay central excise duty? A nightmarish requirement, indeed.

The Government has not withdrawn the other circulars issued on the subject matter of levy of central excise duty and service tax on software licenses, adding to the confusion that prevails. Of course, the controversial and impracticable Notification Nos. 17/2010-ST and 2/2010-ST dated February 27, 2010 have been withdrawn though issuing of Notifications Nos 52/2010 and 51/2010. It might be recalled that, these Notifications had, interalia, required CVD to be paid, by the importer / domestic seller/duplicator, on the entire amount received from the buyer.

The new dispensation would also affect importers of software licenses for their own/internal purposes. It is common knowledge that, large players in the shrink wrapped industry allow great discounts for bulk importers. It would be rather unfair for these importers to be asked to pay CVD on the MRP less 15% abatement, which is bound to substantially increase the overall costs, even for importers importing licenses for internal purposes.

. Be that as it may…..the issue related to the validity of the levy of service tax on the electronic transfer of packaged software licenses, which are already subjected to the levy of VAT, continues to haunt the industry.

Before concluding…….

One does not really understand the need for bringing in packaged software licenses under the MRP based duty scheme. The Industry Associations like ISODA would do well to strongly take this up with the Government and allay, its fears, if any, on any likely evasion of duty under the current scheme.

On a whole, it does seems that the new developments would add to the all round confusion that already prevails, vis-a-vis the packaged software license industry. Wherever possible, one would expect that the industry would shift to the electronic mode of transferring software licenses both for the lesser overall tax impact as well as, for the ease of the importing process.

If at all, this new scheme can be made applicable only for the shrink wrapped software licenses, where the concept of MRP works to a large extent.

The Government would seem to have hastily opened up a pandora's box, by bringing in the entire packaged/canned software industry under the MRP regime, without considering the nuances and complications associated with the industry, which is already suffering due to total lack of understanding from the various wings of the Central and State Governments.

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