Is Vodofone issue eclipsing other and more obnoxious retrospective amendments? – May 25, 2012

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MAY 25, 2012

By S Sivakumar, CA

THE Vodafone issue has been dogging the limelight, for all the right and the wrong reasons. The retrospective amendments proposed in the Finance Bill, 2012, and which have already been passed by the Parliament, to statutorily overcome the decision of the Apex Court in the Vodafone case, have invited a lot of negative reactions from investors in India and abroad. Even, the Government of UK has taken this up strongly with the Indian Government. The debate on whether these retrospective amendments would affect the flow of funds into India goes on, even as the FM and his Ministry colleagues vociferously defend the retrospective amendments, vis-à-vis Voadone.

In all thisgreat Vodafone hullaballoo, we seem to have conveniently forgotten the retrospective amendments proposed in the Finance Act, which would bring payments made for import of shrink wrapped software, into the tax net.

As is known, many Tribunalshad been taking the view that, payment for import of copyrighted article, viz. the software package, is to be distinguished from payment for import of copyright and that, in the case of the former, no liability to pay income tax arises under the provisions of the Double Taxation Avoidance Agreements, vis-à-vis the non-resident. The Karnataka High Court, in the Samsung Electronics case, over-ruled the various decisions given by the Bangalore ITAT and ruled that, payments towards import of shrink wrapped software constituted ‘royalty’ in the hands of the non-residents, taxable in India. In decisions given subsequently, the Delhi High Court, in the Erickson AB and the Dynamic Vertical Software cases, has differed with the view taken by the Karnataka High Court and has taken the view that, payments for shrink wrapped software cannot be treated as ‘royalty’, resulting in tax being levied on the non-residents. The view of the Delhi High Court has been followed by the Bombay Tribunal in some cases.

Even without waiting for the Supreme Court to resolve this contentious issue, the Government has gone in for a retrospective amendment to Section 9(1)(vi) of the Income tax Act, in terms of which, payments for import of shrink wrapped software would now be taxable from 1976 onwards.

Unlike the Vodafone case, which would affect only a handful of foreign investors, the retrospective amendments to Section 9 in terms of software imports, would virtually shut this industry. There are tens of thousands of vendors who import software packages and sell these to domestic customers including, notably, the various organs of the Central and State Governments. As is the practice, most domestic customers prefer to deal with local vendors and this practice has resulted in a huge market involving distribution of imported software packages.

The typical margins that distributors make are in the range of 5 to 7%… theretrospective levy would not only wipe out the margins, but would also result in the closure of many small and medium sized distributors of imported software. The fact that, the income tax would have to be paid for the past years also, would make matters far worse.Needless to say… the retrospective levy could sound the very death knell for this segment.

The Government would be well advised to re-visit this retrospective amendment, given the fact that, this could kill the segment resulting in the closure of tens of hundreds of resellers of imported software packages. Of course, nobody can claim on tax being levied on a prospective basis.

Before concluding …

Most smaller global players in the shrink wrapped software segment prefer to sell in India, through resellers. Most of these players would not agree to bear the tax burden and in a worst scenario, would prefer not to sell in India. This could result in the Indian users being deprived the opportunity of using the latest software packages and tools and to this extent, the Indian entrepreneurs would be deprived of the competitive edge, vis-à-vis their global competitors. The Government needs to keep this important factor in mind.

With this statutory amendment, India would join the list of only a few countries, which levy tax on payments for software imports, treating these as ‘royalty’, within the meaning of the Double Taxation Avoidance Agreements. Given the pressure on tax collections, one cannot, perhaps, argue with the prospective amendments. But, the Government cannot this very segment which pays taxes, in its efforts to spruce up tax collections.

In most western countries, a distinction is sought to be made between software embedded in a hard disk/CD and software downloadable over the Internet. While software inscribed/embedded in hardware is treated as ‘goods’, downloadable software is treated as ‘services’. It’s high time, we had a similar treatment.

One cannot, but, help wondering as to completely contradictory stand taken by the Central Government in terms of levy of income tax vis-à-vis levy of service tax, on software licenses. In

terms of the recent post-Budget TRU Circular issued, the Central Government makes a categorical statement that, transfer of license to use packaged software is 'goods' and that, VAT and not service tax, is applicable. On the other hand, the Government goes back and retrospectively amends the income tax law, holding that, payments made by importers towards import of packaged software is 'royalty', i.e. a service, covered by TDS provisions.

The Government has also taken the view that, the provisions of Section 206AA are applicable to non-resident payees. As most foreign software suppliers have not taken PAN (and would never take PAN, perhaps) in India, the importers would be required to retrospectively deduct tax at source, under Section 195 of the Income tax Act, @ 20%, with effect from April 1, 2010. Given the rather thin margins, as aforesaid, tax liability for the past years, along with interest and possible penalties might far exceed the net worth of most of these companies.

The Government needs to appreciate that, a significant portion of the software imports are consumed by its own Departments and Undertakings. Hence, to this extent, this would be case of beating oneself, with his own hand.

It does looks like that we are giving too much importance to the Vodafone related developments, without bothering to look at the plight of our own software re-sellers and software importers, who face a rather bleak future, due to the retrospective amendments to Section 9(1)(vi). It is sad that, the importance that is given to a foreign investor is not given to tens of hundreds of Indian players. While the FM might be justified in refusing to change his stand vis-à-vis Vodafone, one hopes that he takes a more sympathetic view vis-à-vis the retrospective amendments treating payment towards import of packaged/shrink wrapped software as 'royalty' and levies tax on a prospective basis.

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