

## Service Tax refund to software exporters – ‘Goods’ better than ‘services’ – Jan 2, 2008

### Service Tax refund to software exporters – ‘Goods’ better than ‘services’!

By S Sivakumar, CA

ONE could hardly have missed the screaming headlines that most national newspapers carried on September 18. Commerce Minister, Mr Kamal Nath, has been credited with achieving the impossible, by ultimately getting service tax refund for exporters, five months after he made a tall claim that all service tax related to exports would be refunded, in April 2007. It had earlier been reported in the national press that the Commerce Minister, Mr Kamal Nath had written thrice to the Prime Minister seeking an early notification of service tax exemption for exporters announced in the Foreign Trade Policy in April 2007. Mr Nath had also asked the industry to ‘lobby’ with the Finance Ministry for an early notification. What has ultimately come out, in terms of the Notification No. 40/2007, issued on September 17, after five long months of wait, is a rude shock to exporters, leave alone the fact that the **Notification has nothing for the services exporters and especially, software services exporters.**

It had been popularly claimed that the focus of the Foreign Trade Policy 2004-09 was on reducing the transaction costs and providing incentives to boost exports. One of the long standing major grievances of Software Services Exporters has been that, being an ‘exempted service’, they are not entitled to avail of cenvat credit in respect of any input services. Rule 5 of the Cenvat Credit Rules 2004, dealing with refund of duties and taxes to exporters of goods and services, clearly lay down that such refund is permissible only if the output service which is exported, is a taxable service and **software services being exempt services, refund of duties and taxes incurred on inputs and input services does not arise.**

The situation is totally different in the case of export of taxable services like Business Auxiliary Services (eg. call center services). Since Business Auxiliary Services are chargeable to service tax, when these services are exported, the exporter is entitled to claim a refund of the service tax paid in respect of the input services availed, in terms of the aforesaid Rule 5.

Thus, we have a clear anomaly in terms of a software services exporter being denied refund of the input service taxes paid, while any other services exporter is allowed to claim a refund of the input service taxes paid. This anomaly which was widely expected to be removed by the Finance Ministry, continues to haunt software services exporters.

At the time of the announcement of the FTP Supplement in April 2007, the impact of the service taxes paid on input services was minimal, for software services exporters. However, with the introduction of the levy of **service tax on rental of office / commercial space with effect from June 1, 2007, the scenario has completely changed to the disadvantage of the software services exporters**, with rental costs forming a significant portion of their overall operating costs. Hence, it was all the more important that the Government did something to remove the anomaly vis-à-vis software services exporters, who are already suffering due to the significant appreciation of the rupee in the last few months.

Given the political turmoil in New Delhi, it is very unlikely that anything on this front will happen in the immediate future.

There is however, one legal option that is open to the software services exporters including Software Technology Park units, to try and get a refund of the service tax paid on input services, by treating software that is exported as ‘goods’. This is quite possible and tenable due to the following reasons..

- Software is an excisable item, covered under Item No. 85238020 of the Central Excise Tariff Act, 1985. The scheme of classification of goods under the Central Excise Tariff Act, 1985 and the Customs Tariff Act, 1975 is based on Harmonised System of Nomenclature (HSN). The respective First Schedules to the Central Excise Tariff Act and Customs Tariff Act, have mostly identical sections and chapters; a large number of main tariff Headings are also

identical. Having regard to the provision of an entry in the First Schedule to the Central Excise Tariff Act, if any “goods” are classified under a particular main heading, the same would also hold good for classification of the same “goods” under the Customs Tariff Act.

- It is immaterial if the software that is exported is branded or unbranded. This is important to understand as most of what gets exported, is unbranded software. Despite that the excise duty on ‘unbranded software’ is nil, there is no denying the fact that ‘unbranded’ software is ‘excisable goods’.
- Taking this logic forward, software, whether branded or unbranded, is considered as ‘goods’ for purposes of sales tax and VAT and software is specifically included in the schedule specifying the VAT rates.
- As per the Cenvat Credit Rules, ‘final product’ means ‘excisable goods’, manufactured or produced using inputs or input services. As per Section 2(d) of the Central Excise Act 1944, ‘excisable goods’ are defined as ‘goods specified in the Schedule to the Central Tariff Act, 1985 as being subject to a duty of excise and includes salt’.
- Rule 5 of the Cenvat Credit Rules which deals with refund service tax, talks about the final product being cleared under bond or Letter of Undertaking (‘LUT’). By treating software as the final product, it can be safely said that the refund procedures applicable to excisable goods are very much applicable to software exports, as well. Procedurally, the STP unit or the non-STP software exporter will have to register with the Central Excise Department and keep filing the periodical problems and this should not be a problem.
- In terms of the procedures to be followed, software exporters can indeed export in the non-physical form by direct transmission thro’ satellite or dedicated communication lines, using the prescribed ‘SOFTEX’ form. Other requisite procedures like getting the SOFTEX forms certified by the STPI officials / EPZ officials would continue. While the ARE-1 procedure is meant for the exports of physical goods, software exporters are allowed to use the SOFTEX form based export procedure.
- In terms of the input services in respect of which service tax can be refunded, virtually all services qualify including rentals paid on office space, mobile phones, amounts to consultants, etc.

It is clear then that, by classifying software as goods / products, software exporters including those operating under STPs, can claim a refund of the input excise duties and service tax paid, in terms of Rule 5 of the Cenvat Credit Rules, 2004.

With no signs of the Government taking any effective steps to prevent taxes being exported, software exporters perhaps do not have a choice but to follow the Central Excise procedure.