

Changes give new dimension to software taxation issues

Source: Mint
July 7, 2009

Author: Rajeev Dimri, Partner

Clarification on various software taxation related issues would have ensured fewer disputes, and greater certainty

Taxation of software has been a matter of much debate and discussion. There is still no clarity on the precise nature of a transaction comprising “software”. In fact, several businesses may be paying service tax as well as excise duty on the entire value charged for the software to avoid litigation on this count. Ever since the endeavour of the government to subject IT software to service tax, the issue of double taxation of software, under service tax and excise/customs, has arisen.

The question essentially revolves around bases to be adopted for the purposes of taxing software under excise/customs/service tax regulations.

Regulations on this topic have been evolving, and the changes proposed in Budget 2009 add a new dimension to achieving clarity of incidence of tax on this vexed issue.

The Budget exempts packaged or canned software from excise duty on so much of the “value” that represents “transfer of right to use” of such software. Such transfer of right includes the right to reproduce, distribute and sell such software and the right to use the software components for the creation of, and inclusion, in other information technology software products. The exemption would be available if the provider of the right to use is registered under service tax laws. It therefore appears that the intent is to provide the excise duty exemption only when such value is otherwise liable to service tax.

Similar logic has been applied to the levy of customs duty on packaged software, with the same set of conditions to be satisfied by the importer of packaged software. Accordingly, additional duty of customs in lieu of excise (i.e., excise duty component) would be exempt on so much of the “value” that represents “transfer of right to use” of such software.

The moot point in the issuance of this exemption notification is whether the subject matter of the transaction in itself is “goods” or “services”.

The exemption appears to suggest that the consideration charged for providing the right to use software is a “service”. As such, therefore, there was no requirement of issuing an exemption under excise laws since excise duty cannot apply on transfer of right to use. This matter, while not addressed legislatively, is likely to be a matter of disputes. Clarification on this issue by the legislature would have been much more welcome in the interest of fewer disputes, and greater certainty.

Having said this, another aspect which may be a subject of disputes could be in relation to the coverage of this exemption. While the exemption covers “packaged software or canned software”, it is unclear whether this would also cover software such as gaming, music, entertainment, etc. Even in such cases, there is an implicit transfer of the right to use for a limited purpose and duration. Hence, such transactions may continue to attract service tax as well as excise, and the anomaly/lack of clarity of taxation for such software may continue.

Further, there are several disputes which are pending on the aspect of valuation of software for the purposes of excise and service tax. The amendment is prospective and hence leaves the question about the status of such disputes unanswered. It is likely that the revenue department may seek to rely upon this exemption to take a view that in the absence of the said exemption for the past period, service tax and excise were leviable. The resolution of such disputes may depend largely on the overall interpretation of whether the right to use software is an act of manufacture or the provision of a service.

One hopes that with the introduction of GST, and unification of excise, service tax and value-added tax, the dispute will not be an ongoing phenomenon.

With a plan to implement GST in the next eight months, the wait may not be long!