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This Alert summarises a recent Circular issued by the Commissioner of Commercial Taxes in Karnataka on the levy of Sales tax/ VAT on transactions relating to computer software.

INTRODUCTION

The Commissioner of Commercial Taxes in Karnataka has recently released a Circular No. KSA.CR.76/05-06 dated 24th July 2006 clarifying the levy of sales tax/ VAT on transactions relating to computer software.

This alert summarizes the significant clarifications issued by the Commissioner regarding the levy of sales tax/ VAT on transactions relating to software, in the background of the appropriate cases on the subject.

LEGISLATIVE HISTORY

The judgment of the Supreme Court in the case of *Tata Consultancy Services vs State of Andhra Pradesh*[1], since reaffirmed in the case of *Bharat Sanchar Nigam Limted vs Union of India*[2] has stated that canned software or off the shelf software constitutes goods and is liable to sales tax/ VAT. In the case of customized software, it could be considered to be goods and be liable to sales tax/ VAT in the following circumstances:

- It is capable of being bought and sold;
- It is capable of being transmitted, transferred, delivered, stored and possessed; and
- Based upon the utility

The Karnataka Sales Tax Act, 1957 provides for a levy of works contract, inter-alia on the programming and providing of computer software. Following the decision of the Supreme Court in the *Tata Consultancy Services Case*, the Karnataka High Court has, in the case of *Inventa Software vs Additional Commissioner of Commercial Taxes*[3], stated that programming and development of software by a person will be liable to works contract tax under the Karnataka Sales Tax Act, 1957.

The Government of Karnataka had introduced an amendment to the Karnataka Value Added Tax Act, 2003 and included a schedule for rates of tax on works contract from 1st April 2006. Programming and providing of software has been classified as separate category of works contract under Schedule VI of the Karnataka Value Added Tax Act, 2003.

In light of the above background, the Commissioner of Commercial Taxes in Karnataka has released the Circular No. KSA.CR.76/05-06 on the levy of sales tax/ VAT on transactions relating to computer software.

KEY HIGHLIGHTS OF CIRCULAR

The Circular issued by the Commissioner of Commercial Taxes states that the sale or transfer of property in software for consideration would be liable to tax under the Karnataka Sales Tax Act, 1957 and the Karnataka Value Added Tax Act, 2003 in the following circumstances:

- If it is a case of direct sales of software – Direct sales of software are transactions in which software is sold to the purchaser in deliverable state through appropriate media.
- If it is a case of deemed sales of software – Transfer of property in software in the execution of a works contract would be a transaction, pursuant to a contract, in which a ready software or one which is developed/ programmed as per the specifications of the purchases would be delivered/ supplied to the purchaser by loading to the purchaser's equipment or similar device.
- In the case of any customization, maintenance, upgradation, repair or improving of software, the same may

[1] AIR 2005 SC 371
[2] AIR 2006 SC 1383
[3] Sales Tax Appeal No. 92/1996

also be liable to sales tax if it is classified as a Direct Sale or Deemed Sale.

The following transactions may not attract the levy of sales tax/ VAT in respect of sale of software:

- Provision of manpower or technical services by a dealer for an agreed consideration to any other person to program/ develop software at the premises of either party.
- The software so developed will be the property of the latter and the provider of manpower or technical service will not have any ownership of the software developed.
- Provision of manpower/ services of technical personnel for the purpose of implementing, deploying, testing, maintaining, repairing or upgrading software without any transfer of property in software in the execution of contract for work will not attract any levy of sales tax/ VAT.

CONCLUSION

The Circular has clarified the position adopted by the Commercial Tax authorities on the levy of sales tax/ VAT on transactions relating to software. However, in determining whether a transaction relating to software is taxable under the sales tax/ VAT laws, it would be also be necessary to take note of the judicial precedents that have laid down the circumstances where such transaction is taxable under the sales tax/ VAT laws. The nature of the agreement and the terms and conditions of the agreement between the parties will determine whether a transaction relating to software will be taxable under the sales tax/ VAT laws.

Contact us at ey.taxalert@in.ey.com

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