[This article appeared in “Service Tax Today” Volume 13 Part 8 Page No. 169 dt. 25-4-2008]

Extension of Service Tax to Information Technology Sector – Poaching other Areas-I

by **CA. Pradip R Shah**
e-mail: pradip_shah@vsnl.com

1.0 **End of Adolescent Days**

As it happens in the life of every human being, birth of a child brings joy and happiness. The child gets most coveted attention and, at times, being pampered as well. With the process of time, the child becomes an adult and the approach of the family member’s changes. The child is expected to be mature enough to stand on its own without the help of anybody. This is the natural process as we have been witnessing in various forms of life like animals, birds etc. as well. Looking to the approach of the Government to software sector in the last five years, it appears that the Society is sending messages to the IT Sector to live on its own and not to depend on doles rolled out in the form of taxation relief. As we have been observing in the last five years, sun-set clauses are being introduced with reference to various deductions / exemptions. Within a short span of time, most of the exclusive benefits will stand discontinued. Although some of the aspects of IT sector were brought within the purview of ST earlier, a major portion i.e. development and other ancillary activities were outside its scope. With the proposed amendments that also will come to an end.

2.0 **The proposal**

Budget 2008 proposes to bring major changes in the taxation of IT services. In the process of bringing in the net various aspects of IT sector, as we shall see hereinafter, it also encroaches into other ancillary areas as well. To what extent it is justified or advisable is a matter to be debated. The Budget approaches the problem of taxation of IT sector in two ways viz. defining the ITS and bringing it within the tax net, although not fully but partially.

In the first place it is proposed to insert clause 53 defining the term “ITS”. These 52 words are wide enough to cover not only IT sector as we know in our day-to-day life but other areas as well.

In the second step, clause 65(105)(zzzze) is proposed to be inserted bringing various aspects of ITS within the tax net. It should be kept in mind that it is not the entire gamut of IT sector is within the tax net. Provisions of clause (zzzze) have restricted application viz. to business / commercial application only.

The third major change is with respect to amending various other services which also plays a major role. They are Management, Maintenance or Repair Service, Consulting Engineering Service, Technical Testing and Analysis and Technical Inspection and Certification.

With these insertions and amendments, taxation of IT Sector will come to a full circle bringing an end to exclusive treatment. Taxation of ITS is to be seen from three perspectives viz. Definition of ITS, charging section and overlapping / multiplicity of taxes. S. 65 (53a) defines the term ITS in the widest manner. However, S.

65(105)(zzzze) keeps its taxability restricted. Unfortunately, S. 65(105)(zzzze) has been drafted in such a manner that it encroaches in the area of VAT which is the exclusive are of taxation of the States only. In fact, there are chances of duplication levying both the taxes i.e. State VAT and Service tax as well on the same transaction. An attempt has been made here to analyse S. 65(53a) defining ITS.

3.0 Definition

Proposed insertion of the definition of ITS reads as follow:

‘(53a) “information technology software” means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment;’;

For better understanding it can be represented in a tabular format as follow:

<table>
<tr><th>Representation of</th><th>Format</th><th colspan="2">Characteristic</th><th>Method</th></tr>
<tr><td>Instructions</td><td rowspan="4">Source code
or
Object code</td><td rowspan="4">Recorded in a machine readable form</td><td rowspan="4">capable of being manipulated
or
Providing interactivity to a user</td><td rowspan="4">Means of a computer
or
Automatic data processing machine
or
Any other device</td></tr>
<tr><td>Data</td></tr>
<tr><td>Sound</td></tr>
<tr><td>Image</td></tr>
</table>

Let us look at salient features of the above definition.

a) It is silent about storage media, or medium of transfer. There is no specific reference to the media on which ITS has been stored or recorded. Secondly, there is no reference to how the ITS is being rendered.
b) It includes both system and application programmes.
c) It also includes subdivisions such as assemblers, compilers, routines, generators and utilities.
d) It covers database of any type.
e) Representation of sound i.e. recording of music is covered.
f) Representation of image i.e. picture or video or film shooting is covered as well.

Thus, applicability of ITS is not restricted to the programmes or software used in computers in our day-to-day life but it extends to the areas where the technology of representing instructions electronically is also applied. Whether the areas not connected with computer or software industries will attract ST is another issue to be seen in the context of the provisions of S. 65(105)(zzzze).

4.0 What is it?

Computer software has no specific definition. It is generally referred to as the predetermined set of instructions or programs that the computer carries out. Software, which is inherently intangible, is physically manifested by electronic pulses arranged on a magnetic disk or magnetic tape or on a computer chip. There are three main varieties of software: (1) operating systems, (2) application programs, and (3) data files.

i) Operating Systems: Operating systems are programs that actually instruct the computer on how to operate.

ii) Application Programs: Application programs are the instructions which are actually manipulated by the computer and tell it how to perform various tasks. These include the word processing as well as the Lotus and Excel spreadsheet, Power Point type software.

iii) Data Files: Data files are not instructions but are compilations of certain facts.

The title of the definition "Information Technology Services" as proposed in the Budget 2008 would lead one to believe that the tax will be levied on the services rendered for transferring information through technology and its related aspect. However, it goes much beyond and covers sound recording and shooting / imaging as well. Therefore, as we shall see, apart from software industry, the definition will be applicable to film industry, medical services etc. as well.

4.1 **Any representation**

The definition covers the process of representation. Representation means *presentation in the predefined form.* Activity carried while rendering services under ITS should generate the output in the form of presentation in a predefined format. As per the definition this presentation can be of anything viz. instructions / data / sound or image.

4.2 **Instructions**

In computer science "instructions" means *a line of code written as part of a computer program.* Accordingly, "***representation of instructions"*** means sequence of automatic data processing equipment instructions necessary to solve a problem.

4.3 **Data**

It means "a *collection of facts from which conclusions may be drawn"*. At first sight treating data as ITS may not gel well with set of instructions to communicate with the computers. Data may be raw or the processed one. Looking to the definition, mere act of entering the data on a media and supplying to other person without processing in any respect will also get covered here. One can appreciate processed data as outcome of ITS. However, the definition does not look at the final outcome of the process only but goes back to the early stages of processing or development activities.

4.4 **Sound**

It means a *particular auditory effect produced by a given cause.* It is the subjective sensation of hearing something. Technically speaking it is the audible part of a transmitted signal. Representation of sound in a machine readable form appears to overlap the sound recording services which has been defined u/s 65(98) known as "Sound Recording Service". It covers recording of sound on magnetic media in any manner i.e. cataloguing, mixing, remixing etc. The types of sound generally which are recorded are songs, speeches, drama, film or other dialogues, discourses, educational lectures etc. Therefore, inclusion of representation of sound under ITS will not pose any problem as they are already covered. However, a problem may arise with respect to reproduction of original master to make further copies of the audio tape or CDs etc.

CBEC circular no. B11/1/01/-TRU dt. 9th July, 2001 exempts the same. However, no reasoning has been assigned for the same. But it appears that services covered u/s 65(98) are much broader as, apart from recording the sound on media it also covers other services provided by viz. studio, technical persons, musical instruments, providing different kind of sound from library etc. As such, inclusion of representation of sound is limited in its applicability. But the moot point that will arise now is to what extent exclusion granted to reproduction of original master to make further copies of the audio tape or CDs. Will it not get covered under the definition of ITS?

4.5 **Image**

Image is a *visual representation of an object or scene or person or abstraction produced on a surface*. Image is a picture of a person or an object. It can be an image of a part of the human body as well. If it is so, does it mean that it will cover x-ray photo services provided by radiologists? Will it also cover Sonography, angiography or Magnetic Resonance Imaging (MRI), Endoscopy? Let us examine each of them in detail and see it gets covered as ITS.

4.6 **X-ray Photo:**

It is production of electromagnetic radiation of short wavelength when high-speed electrons strike a solid target. It captures the image of bones and reproduces on film. As long as the image is recorded on a film ITS definition will not apply as it is not recorded in a machine readable form nor it is capable of being manipulated. However, the same service when recorded on a CD or floppy with the advanced machines known as "Digital X-Ray" will get covered. This is for the reason that image captured on a CD or a floppy is capable of being manipulated by a doctor by rotating it or enlarging etc.

4.7 **Angiography:**

Angiography is roentgenographic examination of blood vessels after injection of a radiopaque contrast medium producing an angiogram. Cardiac problems have become common and with the facilities being made available in almost all the cities, angiography is being used widely for capturing the image of artery, veins and the heart. As in the case of digital x-ray, image of blood vessel recorded on a CD or any media is being capable of manipulated by the doctor in the sense that it can be rotated or enlarged.

4.8 **Sonography:**

It is the technology using the reflections of high-frequency sound waves to construct an image of a body organ (a sonogram). It is commonly used to observe foetal growth or study bodily organs. Images created with the help of high-frequency sound is recorded in machine readable form on a CD or other media. It is being capable of being manipulated by a doctor in the sense that it can be enlarged or rotated.

4.9 **Magnetic Resonance Imaging (MRI):**

MRI technology makes use of nuclear magnetic resonance of protons to produce proton density images. It creates the image of cells of a minute nature in a human body. Images are recorded in a machine readable form. As in all other cases as referred to above it can be manipulated by the doctor by enlarging a part of the image or rotating it.

4.10 With the advancement in technology various types of machines are being used in medical science for capturing image of human body. All of these machines are capable of manipulating in following ways.

a) Image processing features like W/L, Brightness & Contrast, Zoom, Pan, Flip, Reverse, Crop etc.
b) Annotations like arrow, text markers, lines, circles can be done on imagines
c) Linear, Angular measurements and area calculations
d) Simultaneous processing of all images by mouse
e) Image sharpening filter
f) Image enhancements filters for increasing the quality of images
g) Viewing matrices
h) Angular rotation
i) Rectangular, Elliptical or freehand image cropping
j) Picture-in-Picture
k) Magnifying Glass
l) Image stitching
m) Facility to place image anywhere in the report

The definition of ITS, cover all of the above. Whether the same are subject to tax or not is another issue to be examined in the context of the provisions of S. 65(105) (zzzze).

5.0 **Format of Representation**

The definition covers representations of instructions etc. in two formats viz. source code and object code. Representing instructions in source code is the most primary one. However, with the technological development and commercialization of software other efficient method has also been developed known as object code. No definition has been provided for the term "object code" but it refers to the machine-language output of a compiler that is ready for execution on a particular computer. Under this format source code is converted into machine readable instructions through compilers and linkers. It should be noted that the applicability of the definition is not restricted to instructions recorded in source or object code only. Use of the word *"including"* implies that it should be in a machine readable form and reference to source and object code is to expand its applicability only. Therefore, representation of instructions in the form other than source or object code is also covered.

6.0 **Typical Characteristics**

The object i.e. text / data / graphics / image should be in a machine readable form. A format not compatible with any machine cannot be included. However, readability by a machine expects existence of media. The definition is silent about the media in which such instructions etc. are stored. It means it can be on any media including print. However, it should be in a machine readable form. A question will arise whether instructions etc. delivered on paper will be covered under the said definition. This is for the reason that machine cannot read it directly. Before it can be made to machine readable format, the instructions on print media etc. has to be scanned and process through a text / picture / image recognizable software. It is only there after it will become fit for being manipulated.

Second condition is that instructions etc. should be *capable of being manipulated.* To *"manipulate" means control (others or oneself) or influence skillfully, usually to one's* *advantage*. The definition is silent about the level of manipulation. Should the instructions etc. be capable of being manipulated fully? For example, a video film containing image of blockade in the vein can be viewed on any computer. However, the user is not permitted to manipulate it in the sense that he can edit any part thereof. At the most, the user can enlarge or rotate a certain portion only. Will this limitation take it out from the definition of ITS?

7.0 **Interactivity**

Another important requirement is with regard to interactivity. “*Interactivity*” means *capable of acting on or influencing each other*. It means that the user should be in a position to *act on it.* Not only that, the object should also *influence* the user. It is this typical characteristic aspect of the software i.e. intelligence incorporated in the instructions which adds value to it.

It is not necessary that all the software should interact with the user. However, the user will be in a position to manipulate it. Therefore, absence of the feature relating to interactivity should not exclude it entirely form the definition.

8.0 **How to make use of it?**

The last limb of the definition imposes a condition that the representation of instructions / image / sound etc. should be capable of being exploited **by means of a computer, an automatic data processing machine, any other device or equipment.** Although the definition is silent about the media on which the instructions etc. are recorded / stored, it should have the capability of being exploited by a machine. This leads to interesting issue. If a doctor carries out angiography of a patient and gives his report on a paper then it will not get covered under ITS. However, if the doctor delivers the recording of image of blood vessels on a CD then it will be covered under ITS.

9.0 **Conclusion:**

Having been treated softly for a long period of time, levying ST will complete the full circle of putting the IT Industry like any other. With the exemptions / deductions under Income tax coming to an end, with the extension of the coverage in the arena of ST, IT Sector will also start feeling the pinch. However, what is surprising is that, in the process, the areas which were hitherto not associated with IT Sector but were becoming heavily dependent on application of IT products will also be brought within the ST net.

(To be continued)

[This article appeared in "Service Tax Today" Volume 14 Part 1 Page No. 1 dt. 2-5-2008]

(Part 2 of a series of 3 Articles)

Extension of Service Tax to Information Technology Sector – Trapping the Golden Eggs- II

by **CA. Pradip R Shah**
e-mail: pradip_shah@vsnl.com

1.0 **Encompassing all the Aspects and Stages**

An interesting aspect of the proposal to levy Service Tax (ST) on software has been referring to it as Information Technology Service (ITS) rather than software. As we have seen in detailed examination of S. 65(53a) ("Service Tax Today", Volume No. 13 Part No. 8 dt. 25-04-2008) the scope for charging tax is much more than what may appear. There are various aspects and stages of ITS. Apart from developing the know-how i.e. software lot many activities goes into pre and post development and at installation stage. The proposal encompasses all these activities. As far as aspects are concerned, other issues emerging from these activities viz. management, testing, repairs and maintenance etc. are also brought within the net of taxation by carrying out various amendments. An attempt has been made here to discuss all the aspects involved therein. The basic issue regarding ITS lending into double taxation i.e. VAT and ST has not been covered here as it requires detailed discussion and will be covered in the third article of the series.

2.0 The Budget, 2008 carries the following proposal for charging ST on ITS.

Providing of services relating to Information Technology Software

After sub-clause (zzzzd), the following sub-clauses shall be inserted, namely:—

"(zzzze) to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including,—

(i) development of information technology software,

(ii) study, analysis, design and programming of information technology software,

(iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,

(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software,

(v) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information

technology software and right to use software components for the creation of and inclusion in other information technology software products,

(vi) acquiring the right to use information technology software supplied electronically;

2.1 As usual, it is quite lengthy and complex making it difficult to comprehend. Apart from that by referring to ITS, it extends to lengthy definition given u/s 53(a). It can be better appreciated only when both are read together. Since reading it in the text form will lead to more confusion, an attempt has been made hereunder to combine both in a tabular format to get some clarity.

<table>
<tr><th></th><th>S. 65(105)(zzzze)</th><th colspan="4">S. 65(53a)</th></tr>
<tr><th></th><th>Types of activities covered</th><th>What is covered?</th><th>Format</th><th>Media</th><th>Method of using</th></tr>
<tr><td>1</td><td>Development</td><td rowspan="23">Instructions
or
Data
or
Sound
or
Image</td><td rowspan="23">Source code
or
Object code</td><td rowspan="23">Recorded in a machine readable form and capable of being manipulated
or
Providing interactivity to a user</td><td rowspan="23">Means of a computer
or
Automatic data processing machine
or
Any other device</td></tr>
<tr><td>2</td><td>Study</td></tr>
<tr><td>3</td><td>Analysis</td></tr>
<tr><td>4</td><td>Design</td></tr>
<tr><td>5</td><td>Programming</td></tr>
<tr><td>6</td><td>Adaptation</td></tr>
<tr><td>7</td><td>Upgradation</td></tr>
<tr><td>8</td><td>Enhancement</td></tr>
<tr><td>9</td><td>Implementation</td></tr>
<tr><td>10</td><td>Advice</td></tr>
<tr><td>11</td><td>Consultancy</td></tr>
<tr><td>12</td><td>Assistance</td></tr>
<tr><td>13</td><td>Conducting feasibility study on implementation of a system</td></tr>
<tr><td>14</td><td>Specification for database design</td></tr>
<tr><td>15</td><td>Guidance and assistance during start-up phase</td></tr>
<tr><td>16</td><td>Laying down specification for securing a database</td></tr>
<tr><td>17</td><td>Advice on proprietary ITS</td></tr>
<tr><td>18</td><td>Acquiring the right to use ITS for commercial exploitation</td></tr>
<tr><td>19</td><td>Right to reproduce</td></tr>
<tr><td>20</td><td>Right to distribute</td></tr>
<tr><td>21</td><td>Sell of ITS</td></tr>
<tr><td>22</td><td>Right to use software components for the creation of and inclusion in other ITS products</td></tr>
<tr><td>23</td><td>Acquiring the right to use ITS supplied electronically</td></tr>
</table>

Dissecting the Issue

3.0 The very basis of attracting tax is that the services related to ITS should have been provided *to any person, by any other person in relation to information technology software for use* ***in the course, or furtherance, of business or commerce.*** Experience has shown that levying tax on the basis of end-use raises hosts of new issues particularly tax administration. It is difficult to ensure compliance with such conditions giving rise to various legal issues. Now, as we all know ITS, apart from finding application in business or commerce, is also being bought and sold for ones personal requirements as well. Two examples of it will be sufficient to explain the complexity.

Mr. X buys anti-virus software from website of a developer based in Bangalore for his desktop. He is not carrying any business and has been using the computer system for personal requirements. The software bought permits Mr. X the right to use only. He is not permitted to copy or distribute it. In terms of clause (vi) acquisition of the right to use electronically is considered as rendering of service. The issue arises whether the developer of the software based at Bangalore will be liable for ST? How does he ensure that the ITS is for business or commercial uses? In order to lessen the tax burden, Mr. X would not like to pay 12.36% ST. He may also intimate it to the vendor / developer about not using for any business or commercial purposes. The real problem will arise for the developer / vendor of ITS as he will have to satisfy the ST Department about the end-use of the ITS. How will he ensure end-use of his products other than business purposes? Even assuming that a declaration is obtained from Mr. X a question will arise for which time frame it should be applicable? Should it be forever? If so, who will ensure its implementation?

Let us take another example.

Mr. I is an investor in shares and securities. For the purpose of carrying out analysis of movement in prices over long timeframe, has purchased software developed by M/s S Ltd. Since the liability to pay ST is on M/s S Ltd. how will it ensure that Mr. I is not carrying on any business or will not use it for carrying on business of trading in shares and stock? In the next year Mr. I convert his holding in shares of various companies into stock-in-trade and use the same software for trading activities. Mr. I have also contracted with M/s S Ltd. for up-gradation and maintenance of the same software. How M/s S Ltd. will ensure its application to personal use only by Mr. I?

3.1 The whole issue arises from the typical nature of ITS finding its application in the personal and business / commerce as well and its easy adaptability to either of them. Software finds its place in day-to-day life for personal use as well. Users are buying ITS related to Internet, antivirus utilities, software related to accounting, finance, investment etc It is for these reasons this is going to be the most taxing issue for the taxpayers and the ST Department equally.

3.2 Clause No. (i) to (vi) can be classified from various aspects as follow:

3.3 **Pre-development Stage**

(ii) *study, analysis, design …… of information technology software,*

(iv) *providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation*

of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software,

3.4 **Development Stage**

(i) development of information technology software

(ii) ………. programming of information technology software,

3.5 **Installation Stage**

(iii) adaptation, …… implementation and other similar services related to information technology software,

(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, …….. guidance and assistance during the startup phase of a new system, ……..

3.6 **Post-development Stage**

(iii) adaptation, upgradation, enhancement, …… and other similar services related to information technology software,

(v) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,

(vi) acquiring the right to use information technology software supplied electronically;

3.7 As can be seen, drafting of the clauses is not on any predetermined methodology to cover all the aspects. There are clauses covering more than one aspect. In the same manner, a clause contains different services covering different aspects. Terms not applicable to a particular aspect has been deleted with the marking "…." to maintain the continuity.

Activities of Rendering the Services

4.0 Items No. 1 to 17 of the above table are clear case of rendering of the services. However, the more disturbing parts are item No. 18 to 23. Item No. 18 to 22 refers to acquisition of the right, sell etc. of IT'S A clear case of encroaching in the arena of VAT. To what extent this is within the provision of Article 366(29A)(d) of the Constitution is going to be a matter of debate. However, of all the most interesting, and unexpected item to be found is *"acquiring the right to use ITS supplied electronically"*. Clause (v) has taken care of acquisition of the right in an extensive manner. However, inclusion of clause (vi) shows over cautious approach to the whole issue. There appear to be a feeling somewhere in CBEC that mode of delivery may take out ITS from the purview of ST. In fact, the same clause could have been inserted as an Explanation at the end of the clause (zzzze). Its inclusion as item no. (vi) is baffling.

Contradictory Approach?

5.0 The Budget proposal carries insertion of new service called Supply of Tangible Goods without transferring Right to use the goods. Letter No. D.O. F. No.334/1/2008-TRU Dt. 29th February, 2008 explaining the provisions in this respect has to say as follow:

> *4.4 SUPPLY OF TANGIBLE GOODS FOR USE:*
> *4.4.1* ***Transfer of the right to use any goods is leviable to sales tax / VAT as deemed sale of goods [Article 366(29A)(d) of the Constitution of India].*** *Transfer of right to use involves transfer of both possession and control of the goods to the user of the goods.*
>
> *4.4.2 Excavators, wheel loaders, dump trucks, crawler carriers, compaction equipment, cranes, offshore construction vessels & barges, geo-technical vessels, tug and barge flotillas, rigs and high value machineries are supplied for use, with no legal right of possession and effective control. Transaction of allowing another person to use the goods, without giving legal right of possession and effective control, not being treated as sale of goods, is treated as service.*
>
> *4.4.3 Proposal is to levy service tax on such services provided in relation to supply of tangible goods, including machinery, equipment and appliances, for use, with no legal right of possession or effective control.* ***Supply of tangible goods for use and leviable to VAT / sales tax as deemed sale of goods, is not covered under the scope of the proposed service.*** *Whether a transaction involves transfer of possession and control is a question of facts and is to be decided based on the terms of the contract and other material facts. This could be ascertainable from the fact whether or not VAT is payable or paid.*

[Emphasis supplied]

5.1 The very first sentence recognises the right of the State Government in respect of taxability of the Transfer of the right to use any goods to sales tax / VAT as deemed sale of goods [Article 366(29A)(d) of the Constitution of India]. If that is the case, why is it that different treatment meted out to ITS? Why is it proposed to levy ST on acquisition of the right to acquire ITS? By its own admission CBEC states that "***Supply of tangible goods for use and leviable to VAT / sales tax as deemed sale of goods, is not covered under the scope of the proposed service."*** If it so for all the tangible goods why not for ITS? How and in what respect they are different?

5.2 Contradiction can be seen in respect of another item as well. It is also proposed to insert the following clause:

> *'Explanation.— For the removal of doubts, it is hereby declared that for the purposes of this clause,—*
> *(a) "goods" includes computer software;*
>
> *(b) "properties" includes information technology software*

If for the purpose of Management, Maintenance and Repair Services computer software is goods and properties why should it not be extended to its logical end viz. applying the provisions relating deemed sales for right to use the goods?

Ancillary Amendments:

6.0 Explanation to management, maintenance or repair services has been amended. After the amendment it will read as follow"

(64) "management, maintenance or repair" means any service provided by—

(i) any person under a contract or an agreement; or

(ii) a manufacturer or any person authorised by him, in relation to,—

(a) management of properties, whether immovable or not;

(b) maintenance or repair of properties, whether immovable or not; or

(c) maintenance or repair including reconditioning or restoration, or servicing of any goods, excluding a motor vehicle;

Explanation: For the removal of doubts it is hereby declared that for the purposes of this clause

a) "goods" includes computer software

b) "properties" includes ITS

Mark here the wordings computer software has been treated as "goods" while ITS has been treated as "properties". However, the term computer software has not been defined. Secondly, unlike in the case of ITS there is no reference to use of the software in business / commerce. Does it mean that services like maintenance, repairs etc. to the software for personal use will be subject to ST?

Consulting Engineer Service

7.0 Clause relating Consulting Engineering Service is also proposed to be replace by a new clause. It reads as follow:

(105) "taxable service" means any service provided or to be provided,—

"(g) to any person, by a consulting engineer in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering including the discipline of computer hardware engineering.

Explanation.— For the purposes of this sub-clause, it is hereby declared that services provided by a consulting engineer in relation to advice, consultancy or technical assistance in the disciplines of both computer hardware engineering and computer software engineering shall also be classifiable under this sub-clause."

One can appreciate the reference to advice etc. with respect to computer hardware engineering. However, reference to computer software engineering is perplexing. Is S65(105)(zzzze) not wide enough to cover the same? Was there any need to duplicate it?

Secondly, reference is to *"computer software"* without defining the same. As we have seen, definition of S. 65(53a) of ITS is much wider. What logic there can be using the term which has not been defined and not using the one which has been defined?

Technical Testing & Analysis

8.0 Amendment is proposed in Technical Testing and Analysis Service also by inserting the words ITS. After the amendment the said clause will read as follow:

> *(106) "technical testing and analysis" means any service in relation to physical, chemical, biological or any other scientific testing or analysis of goods or material or* ***information technology software*** *or any immovable property, but does not include any testing or analysis service provided in relation to human beings or animals.*

With the proliferation of application of software in various applications, it has assumed critical status. It has therefore become necessary to ensure that the final product is error free. Many software professionals have specialized in this area and started rendering exclusive services in the field of testing of software. Such services will be covered under this clause.

Technical Inspection & Certification

9.0 Services relating to Technical Inspection and Certification are proposed to be amended by inserting the word ITS. After the amendment it will read as follow:

> *(108) "technical inspection and certification" means inspection or examination of goods or* ***process or material or information technology software*** *or any immovable property to certify that such goods or* ***process or material or information technology software*** *or immovable property qualifies or maintains the specified standards, including functionality or utility or quality or safety or any other characteristic or parameters, but does not include any service in relation to inspection and certification of pollution levels;*

Conclusion:

10.0 The main source of inconsistency is that the Government has not relied on coherent policies or rationales in their approach to software taxation. Rather, it has been construed and classified in the manner most advantageous to its own coffer. The result is a hotch-potch of incongruous standards for tax treatment.

(To be concluded)

[This article appeared in "Service Tax Today" Vol. 14 Part-6 dt. 6-6-2008]

Extension of Service Tax to Information Technology Sector – A Wonderland of Taxation-III

(Part 3 of a series of 3 Articles)

by **CA. Pradip R Shah**
e-mail: pradip_shah@vsnl.com

Going to the Roots:

1.0 Software defies a simple tangible / intangible characterization as it inherently embraces both tangible and intangible elements. It ranks as perhaps the leading technology which defies easy classification. One problem is that the industry itself does not clearly define the term software. The programme is the intangible element which includes the intellectual contents of the program like function, internal design, algorithms as well as property rights viz. patent, copyright, trade secrets etc. The ambiguity crops up when the program is expressed in some tangible medium such as a CD or a floppy. This tangibility aspect leads sales tax authorities to levy tax on it.

Perhaps it is because of the multiplicity of forms which can embody software that much of the difficulty arises in the tax area. Software can assume at various times aspects of a service transaction, tangible personal property or intangible property. Because tax statutes often tax each of these differently, this results in confusion under the tax regimes.

Indian Scenario:

2.0 With the judgement of the Supreme Court (SC) in the case of **Tata Consultancy Services Vs. State of Andhra Pradesh (SC) 2004 271 ITR 405** confusion regarding taxability of software under sales tax has come to an end. In order to appreciate the complexity of the problem in totality i.e. VAT, Service Tax (ST) and Excise Duty, it will be worthwhile to have a look at the reasons cited and various other aspects touched upon by the SC. Briefly stated they as follow:

Factual Matrix

2.1 TCS provide consultancy services including computer consultancy services. As part of their business they prepare and load on customers' computers custom made software known as "uncanned software" and also sell computer software packages off the shelf known as "canned software". The canned software packages are of the ownership of companies / persons, who have developed those software. TCS is licensees with permission to sub-licence these packages to others. The canned software programmes are programmes like Oracle, Lotus, Master Key, N-Export, Unigraphics, etc.

The question raised in the appeal was whether the canned software sold by TCS can be termed to be "goods" and as such assessable to sales tax under the AP Sales Tax Act.

Submission of TCS:

2.2 On behalf of TCS it was submitted:

1) The term "goods" in section 2(h) of AP Sales Tax Act only includes tangible moveable property and the words "all materials, articles and commodities" also cover only tangible moveable property and that computer software is not tangible moveable property.

2) Computer software is nothing but a set of commands, on the basis of which the computer may be directed to perform the desired function. Software is completely unlike a book or a painting. In the case of software, the consumer does not get any final product but all that he gets is a set of commands which enable his computer to function. Having regard to its nature and inherent characteristic, software is intangible property which cannot fall within the definition of the term "goods" in section 2(h) of the said Act.

3) Majority of the American courts have held that software is an intangible property. The reasoning for arriving at this conclusion is basically that the information contained in the software programs can be introduced into the user's computer by several different methods, namely, (a) it could be programmed manually by the originator of the program at the location of the user's computer, working from his own instructions ; or (b) it could be programmed by a remote programming terminal located miles away from the user's computer, with the input information being transmitted by telephone ; or (c) more commonly the computer could be programmed by use of punch cards, magnetic tapes or discs, containing the program developed by the vendor.

Contentions of Revenue

2.3 On behalf of the Revenue, it was pointed out that:

The difference of opinion among the various American courts has arisen because under the American statutes what is taxable is "tangible personal property". It is this definition, which required the American courts to consider whether software is tangible or intangible. The definition of the term "goods" in the AP Sales Tax Act is a very wide definition. The term "goods" have been defined to mean all kinds of moveable property except those specified, namely, actionable claims, stocks, shares and securities.

Views of Supreme Court

2.4 Views expressed by the Supreme Court:

1) For the purposes of sales tax the term "goods", cannot be given a narrow meaning. Properties which are capable of being abstracted, consumed and used and/or transmitted, transferred, delivered, stored or possessed etc., are "goods" for the purposes of sales tax. In India the test, to determine whether a property is "goods", for the purposes of sales tax, is not whether the property is tangible or intangible or incorporeal. *The test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed, etc. <u>Admittedly in the case of software, both, canned and uncanned, all of these are possible.</u>*

2) In the case of Associated Cement Companies Ltd. v. Commissioner of Customs reported in [2001] 124 STC 59, the question was whether customs duty was leviable

on technical material supplied in the form of drawings, manuals and computer disc, etc. It is true that what the appellants had wanted was technical advice on information technology. Payment was to be made for this intangible asset. *But the moment the information or advice is put on a media, whether paper or diskettes or any other thing, then what is supplied becomes a chattel.* The foreign collaborators part with them in lieu of money. It is, therefore, sold by them as chattel for use by the Indian importer. The drawings, designs, manuals, etc., so received are goods on which customs duty could be levied. Therefore, the intellectual input in such items greatly enhances the value of the papers and ink in the aforesaid examples. This means that the charge of duty is on the final product, whether it be the encyclopedia or the engineering or architectural drawings or any manual.

3) The term "goods" as used in article 366(12) of the Constitution of India and as defined under the AP Sales Tax Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. *The copyright in that programme may remain with the originator of the programme. But the moment copies are* ***made and marketed****, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (in case of painting) or computer discs or cassettes, and* ***marketed would become "goods".*** *We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD.*

Branded and Unbranded Software

2.5 It was pointed out that so far as 'unbranded software' is concerned, it is undoubtedly intellectual property and is outside the ambit of 'goods'." It was submitted on behalf of TCS that the High Court correctly held that unbranded software was "undoubtedly intellectual property", the High Court fell in error in making a distinction between branded and unbranded software, and erred in holding that branded software was "goods". However, SC opined that *there is no distinction between branded and unbranded software.* In both cases, the software is capable of being abstracted, consumed and use. In both cases the software can be transmitted, transferred, delivered, stored, possessed, etc. *Thus, even unbranded software,* ***when it is marketed / sold****, may be goods.* Since the SC was not dealing with this aspect and , therefore, did not express opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or ***whether the contract is a service contract may arise***.

(Emphasis supplied)

In a Nutshell:

3.0 It is true that software is intangible and knowledge, the moment it gets recorded on a media it gets the characteristics of the goods. Accordingly, for tax purposes it should be treated as goods only. Secondly, whether it is branded or unbranded does not make any difference, it remains as goods. Thirdly, there may be service contract under which software is supplied on a media. However, no views were expressed. Since taxation of goods under the Constitution of India is State subject, sales tax / VAT can be levied.

An offshoot of this is that, in terms of Article 366(29A)(d) of the Constitution making available right to use the goods being treated as Deemed Sale of goods, sale of software can be subject of Sales Tax / VAT.

Excise and Software:

4.0 In terms of Tariff Entry No. 8523 80, canned software is subject to Excise Duty (ED). It should be remembered that customized software is outside the purview of ED.

Canned Software

5.0 Software can also be classified as “canned software” and “customized software”. ‘Canned software’ means software which is not specifically created for a particular user. It is a prewritten program requiring no modification for consumer use.

Customised Software

6.0 Customized software is a programme developed for specific customer needs. Two principles are followed for classifying software as intangible: viz. (1) software is knowledge, and (2) software encompasses an array of services.

6.1 According to the Knowledge Principle, the sale of software is the sale of knowledge, an acknowledged intangible. The tangible means of transmitting this knowledge is merely incidental to the transaction. Therefore, the more separable the content is from the container, the more the transaction looks like a sale of intangible knowledge.

According to Personal Services Principle the consumer of custom software actually buys the programmer’s service, knowledge, and labor in solving a particular problem. The software is merely incidental to the rendering of the service. The personal services principle is a narrower justification for intangibility than the knowledge principle.

6.2 Distinguishing features of the difference between canned software and custom software can be classified as follow:

(a) whether the transfer of property was incidental to effect the transaction’s primary purpose;

(b) whether the value of the service far outweighed the value of the property on which the program is transferred; and

(c) whether the product transferred was valuable primarily to the user rather than the general public.

These are important aspects to be kept in mind while structuring the transaction and avoid VAT.

Tax implications of Canned Software

7.0 The sale or lease of, or granting a licence to use, canned software is not automatic data processing and computer services, but is the sale of tangible personal property. A programmer provides no specific personal services to a canned software purchaser because canned software is sold ‘off the shelf.’ Therefore, the property transfer cannot be incidental to a rendering of a specific service. For service contract, the product’s primary value should be to the user rather than to the general public. Canned software is not written for the specificity of a single user, but for the general use of the public. Therefore, it will be treated as goods and attract sales tax / VAT. As explained, it will not attract ST as no service is being rendered. It is for these reasons ED is being levied on canned software. In order to plug the loophole of treating customized software as canned software paying ED @8.00% instead of ST @12.00%, rate of ED on canned software has been raised from 8.00% to 12.00%.

Grey Area:

8.0 When a vendor, in a single transaction, sells canned software that has been modified or customized for a particular consumer, will raise various issues. Will it be subject to ED or ST? Will it attract VAT or not? This will remain a grey area.

Alice in Wonderland of Software Taxation

9.0 Even Alice would have certainly been baffled by all these. Having tried to understand the characteristic of software as goods, service aspect of the software, basic definition of ITS, various types of activities termed as services, applicability of ED, VAT and ST, let us try to put it in a comprehensive way which can be understood easily and follow it in day-to-day life. An attempt has been made here to tabulate the same. Nature of the activity treated as services as defined u/s 65(105)(zzzze) has been treated as driving one to evaluate for applicability of ED, ST and VAT.

	Types of activities covered	of	Central Excise	Service Tax	VAT
1	Development	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
2	Study	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
3	Analysis	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
4	Design	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
5	Programming	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
6	Adaptation	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
7	Upgradation	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
8	Enhancement	Instructions	No	Yes	No

		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
9	Implementation	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
10	Advice	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
11	Consultancy	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
12	Assistance	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
13	Conducting feasibility study on implementation of a system	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
14	Specification for database design	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
15	Guidance and assistance during start-up phase	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
16	Laying down specification for securing a database	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
17	Advice on proprietary ITS	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
18	Acquiring the right to use ITS for commercial exploitation	Instructions	No	Yes	Yes
		Data	No	Yes	Yes
		Sound	No	Yes	Yes
		Image	No	Yes	Yes
19	Reproduction (Canning)	Instructions	Yes	No	Yes
		Data	Yes	No	Yes
		Sound	Yes	No	Yes
		Image	Yes	No	Yes
20	Right to distribute	Instructions	No	Yes	Yes

		Data	No	Yes	Yes
		Sound	No	Yes	Yes
		Image	No	Yes	Yes
21	Sell of ITS	Instructions	No	Yes	Yes
		Data	No	Yes	Yes
		Sound	No	Yes	Yes
		Image	No	Yes	Yes
22	Acquisition of right to use software components for the creation of and inclusion in other ITS products	Instructions	No	Yes	Yes
		Data	No	Yes	Yes
		Sound	No	Yes	Yes
		Image	No	Yes	Yes
23	Acquiring the right to use ITS supplied electronically	Instructions	No	Yes	No
		Data	No	Yes	No
		Sound	No	Yes	No
		Image	No	Yes	No
24	Sale of Canned Software	Instructions	Yes	???	Yes
		Data	Yes	???	Yes
		Sound	Yes	???	Yes
		Image	Yes	???	Yes

Overlapping Activities

10.0 Real problem arises in respect of item no. 20 to 24. At a glance it will look like trading activities and difficult to comprehend it as services. What is more disturbing is the language used in S. 65(105) (zzzze)(v). Read the following clause carefully:

> *S. 65 (105)*
>
> *"taxable service" means any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce,* ***including, acquiring the right to use information technology software for commercial exploitation*** *including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,*
>
> (Emphasis supplied)

10.1 In order for any activity to be taxable, the service provider has to provide / render the service. However, the inclusive part of the clause (v) refers to acquisition by the recipient of the services. One can acquire something from other when that other person is providing it. However, if that aspect of the activity i.e. providing the right to use is included then it will attract the Article 366(29A)(d) regarding deemed sale which is meant exclusively for the State Government. It is for the Courts to decide whether it is legally permissible for the Central Government to encroach in the area of State Government.

10.2 Secondly, the definition goes further and embraces the activities like distribution and sell of ITS. Is it permitted to bring to taxation the activities by clothing or naming it artificially and putting it into unnatural form? Apart from that, leaving aside legal semantics, how can one be considered to be rendering the service when the other person is acquiring the right to use the goods? How can two aspects of the same transaction have different characteristics? Can it be said that from the perspective of a seller it is sale of goods attracting VAT and from the perspective of a buyer it is receiving the services attracting ST?

Apparent Contradiction:

11.0 One may get an impression that the draftsman may be oblivious of the fact of the definition of deemed sales as provided in Article 366(29A)(d) of the Constitution. However, look at the insertion of the services relating to "Supply of Tangible Goods without transferring Right". Read the relevant clauses of Letter No. D.O. F. No.334/1/2008-TRU Dt. 29th February, 2008 explaining the provisions in this respect:

> *4.4 SUPPLY OF TANGIBLE GOODS FOR USE:*
> *4.4.1* ***Transfer of the right to use any goods is leviable to sales tax / VAT as deemed sale of goods [Article 366(29A)(d) of the Constitution of India].*** *Transfer of right to use involves transfer of both possession and control of the goods to the user of the goods.*
> ….
> *4.4.3 Proposal is to levy service tax on such services provided in relation to supply of tangible goods, including machinery, equipment and appliances, for use, with no legal right of possession or effective control.* ***Supply of tangible goods for use and leviable to VAT / sales tax as deemed sale of goods, is not covered under the scope of the proposed service.****.*

So, CBEC and the draftsman are fully conscious of the right of the State Government in this respect. The only guess one can make is that the Central Government must be having some innovative argument in this respect and making it confident of the extension of ST to acquisition of right for ITS.

Defining the Danger Zone

12.0 As discussed above, with the insertion of certain activities related to ITS as services under ST, a danger zone has appeared on the horizon. This is for the reason that certain clauses of the provisions of S. 65(105) (zzzze) will encroach in the area of VAT making the activity liable to both the taxes i.e. VAT and ST(or ED as well). It will be too burdensome to bear the burden of both of them. In many cases, it may appear economical to pay ST as it will help in availing CENVAT Credit, which at present cannot be utilized. To that extent the burden may not appear to be so high. However, the case of a dealer / distributor dealing in software products, paying VAT as at present, will be the worst as transfer of right, even limited one, will attract ST @12.36%. In these cases, CENVAT Credit element may not be there, making the life more difficult. The most interesting case will be that of a person who, apart from developing the software, also trades in. In such cases, the activity attracts both the taxes although in limited sense to certain aspects of the transactions only. Insertions of ITS will give an opportunity to ST Department to have a look at the transactions which fall exclusively within the realm of VAT. In the same manner, VAT Department will get an opportunity to have a look at the transactions which are predominantly of service nature. Both of them will try to poach in others' area at the cost of the taxpayers. Let us examine various scenarios emerging.

Service being subjected to VAT

13.0 Reading of SC judgement in the case of TCS, one may get a feeling that even delivery of customized software on a CD will be treated as goods and subject to VAT. However, at certain point it had come to deal with this aspect but left it without discussing it. It did not express opinion about unbranded software and stated that it may also be goods. At the same time, it also hinted at the service aspect of the contract between the parties. Although not stated specifically, what emerges is that if the delivery of software on a CD is a part of the performance of the service as agreed upon, the question of VAT being applied should not arise. Therefore, software developers will have to be more cautious while fixing the terms and conditions and executing the agreement. However, in view of the proposed amendment in the Finance Act, ST will be applicable.

Sale of software products being subjected to ST

14.0 The worst condition will be that of the distributors / retailers as they will fall prey to both the taxes. As far as VAT is concerned, after the SC judgement in TCS, they do not have any choice. Almost all the State Governments have made sale of software as taxable under VAT. Since the rate of tax is moderate, at almost 4.00%, it did not raise any major issue. However, if the same distributor / dealer has to pay ST @12.36% over and above 4.00% VAT, certainly it will be last straw.

14.1 Another issue that will crop-up is regarding charging ST in the case of software being used for business / commercial purposes. How to ensure end-use will be a major headache. This is particularly for a retailer who is in the last point in the chain and sales software products to actual users. His composition of customers will be comprising of both i.e. for business / commercial and personal use as well. All these are bound to lead to unhealthy practices.

A case of Triple Taxation?

15.0 The proposal may, in some cases lead to triple taxation i.e. ED, ST and VAT. Consider the case of a developer of software who develops, canned it, store and sell. As far as ED and VAT are concerned there is no doubt about its applicability. However, consider the case of a dealer who buys it from the developer for retail trade. Software purchased already contains ED and VAT charged by the developer. Such developers are permitted to distribute / sell only. They do not own the software. They acquire limited right to distribute / sell only. Will this act of acquisition not covered under clause (v) i.e. *acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software?* If so, what will be the overall tax burden?

15.1 What will be the additional burden? Let us have a look at pre Budget scenario.

	Rs.
Selling price of canned software at the Developer's end	100.00
Add: Excise duty thereon @ 8.00%	8.00
Total	108.00
VAT @ 3.00% thereon (CST Sale with C Form)	3.24
Total cost for buying dealer	111.24
Add: 10.00 % margin on Rs. 111.24	11.12

Selling Price	122.36
Add: VAT @ 4.00% (being local Sale - No Input Credit for CST)	4.89
Cost to the buyer	127.26

15.2 Post Budget Scenario:

		Rs.
Selling price of canned software at the Developer's end		100.00
Add: Excise duty thereon @ 12.00%		12.00
Total		112.00
VAT @ 3.00% thereon - (CST Sale against C Form)		3.36
Total cost of purchase for buying dealer		115.36
Service Tax on Rs. 115.36 @ 12.00% (borne by buying dealer due to acquisition of the right to distribute)	13.84	
Less: CENVAT Credit for ED paid	12.00	
Additional burden due to VAT on ED not being entitled for CENVAT Credit		1.84
Total cost of purchase for buying dealer		117.20
Add: Dealer's margin @ 10.00% on Rs. 117.20- assuming CENVAT Credit of Rs. 12.00 is passed on to the buyer and no margin is loaded on the same)		11.72
Selling price for dealer		128.92
Add: VAT @ 4.00% on Rs. 128.92		5.16
Cost to the buyer		134.08

If the said software has been purchased for personal use, ST will not be applicable. However, if it is sold to someone using it for business / commercial purposes, question of applicability of ST will arise. Should it be added @ 12.00% on Rs. 134.08 or Rs. 128.92? If it is computed on Rs. 134.08 ST will be Rs. 16.09 otherwise Rs. 15.47.

15.3 Additional impact is for the following reasons:

a) Raising of ED from 8.00% to 12.00%
b) VAT on additional ED
c) ST on ED and VAT
d) Additional VAT on incremental taxes as above

15.4 Above working is on the presumption that the distributor / dealer is entitled for CENVAT Credit for ED paid. However, it involves the hassles of paying the ST on acquisition of ITS products, claiming the same as input credit on sale of it. It also involves blocking of working capital and lots of paper work.

15.5 One may also be wondering levying of ED and charging of ST on the same transaction. However, it should be appreciated that ED has been paid on the canning of software while ST gets attracted on acquisition of the right to use ITS as provided for in the budget proposal. Is it permitted under the Constitution or not is matter of debate.

In any case, the dealer / distributor who were not within the net of ST, will fall into it, with all the associated hassles.

<u>A ray of Hope:</u>

16.0 In the case of software developers who were exporting the same, and not within the ST net so far, will find it quite advantageous. This is for the reason that development of software not being taxable it was not possible to seek refund of CENVAT Credit paid on various inputs and input services. However, with the scope of ST being extended, export of software will fall into exempted category making it possible to claim refund of the same. Of course, the benefit of the refund will not be available to the full extent, as we all know the cost of claiming refund of ST and human resources to be devoted for the same.

<u>Any Alternative?</u>

17.0 Is the subject of software so complex which can lead to this kind of jungle of taxation? Is it not possible to have functional approach? Can we not adopt a system in which software is differentiated according to function? Perhaps, it can remove the disparity problem by shifting the focus away from the inherently dichotomous goods / services characterization of software. Is it possible to differentiate it as operational and applications software? The taxing structure might be defined such that operational software would be subject to ED and VAT and applications software is subject to ST as the intangible program is the basis of the bargain. This alternative contains the prime attributes of efficiency, certainty, equity, and positive economic effect. In the initial years, it may perhaps, involve loss to the Central Government in some form. But, in the same manner, State Government may loose in some other form as well. However, taxes levied with certainty and equity can lead to 1+1=3 rather than this kind of confusion which makes it to 1+1=0.5.

<u>Conclusion:</u>

18.0 Various conclusions can be drawn from all these. We claim that India has tremendous technical manpower making technological wonder. But always remember, in India, it can never surpass the administrative power the bureaucrats have in wilting it. No one has any complain against paying the taxes. What hurts the most is lousy drafting of the laws forcing the human resources of high caliber to divert their energy and skill to unproductive things.

Concluded