

## ITs not easy – Travails of the Sector

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GST in India will usher in a new dawn making in the tax polity with its unprecedented political unanimity. The advantages of moving to the GST are copious. Apart from cutting back a mystifying array of taxes, it will ease the problems caused by widespread “cascading”.

Michael Keen, Deputy Director, Fiscal Affairs Department, International Monetary Fund, through his working paper, “Targeting, Cascading and Indirect Tax design” has explicated the concept of deadweight loss that vitrines taxing only the final consumption can help Government raise the equivalent amount of revenue and also leave patrons facing reduced prices. In this backdrop, the current study is an attempt to review the impact of GST on Software Industry in India. Let’s confer various concepts of the enactment with reference to the software Industry in question.

### Classification:

The levy in case of GST has shifted from several points of taxation like manufacture, removal, delivery, provision, sale, etc. to a single theme i.e. supply. This unification of point of taxation has led to single tax i.e. GST being levied on supply as against Value added tax, Service tax, etc.

Though not completely, the muddle that IT industry had been facing whether to classify software as a good or service has come to an end to an extent.

Explanation to Clause 5 of Schedule II of CGST Act, 2017 provides that “Development, design, programming, customization, adaptation, up gradation, enhancement, and implementation of information technology software shall be treated as Supply of Service”.

Following table is an attempt to capture the various possible supplies in IT/IT Enabled Services Industry and its treatment in GST:

| <b>S.no</b> | <b>Description</b>  | <b>Nature of Supply</b> | <b>Supporting Provisions in GST Act</b>  |
|-------------|---|-------------------------|--|
| 1           | Sale of Software with Source code and exclusivity         | Goods                   | Movable property (intangible not excluded in the goods definition)   |
| 2           | Sale of software with source code and without exclusivity | Not Clear               | Tata consultancy services vs State of Andhra Pradesh 2004 (178) E.L.T. 22 (S.C.) has reasonably settled view of off-the-shelf software being called as goods – however it is not clear if the same view would be |

|   |   |          |  |
|---|---|----------|--|
|   |   |          | adopted in GST   |
| 3 | Software design, development, customisation etc | Services | Clause 5(d) of Schedule II of CGST Act, 2017 and is in line with Declared Services of the present law (Section 66E of Finance Act, 1994) |
| 4 | Licencing of software – Temporary/perpetual     | Services | Either under Clause 5(c) or clause-1 (b) of Schedule II  |
| 5 | Computing platform                              | Services | Either under Clause 5(c) of Schedule II or clause 1 (b) of Schedule II   |
| 6 | IT Enabled services                             | Services | The basic nature of activity itself is service and there is no possibility of classifying under goods                                    |

*Composite Supply:* Levy of GST under Section 8 of the CGST Act, 2017 enunciates that in case of Composite Supply, **Principal Supply** is to be identified and the transaction shall be treated as supply of such principal supply. This has the potential to open further litigations because if an IT company is supplying their software (goods) and also doing a customization, will it be treated as supply of Goods or Services?

1. Treatment of Purchase of OS/MS office along with computer and purchase OS/MS office separately?
2. Treatment of software (games) supplied along with the play station and purchase of additional games through CD or downloadable version?
3. Which is to be taken as the Principal Supply, is it the Goods or Services. This question arises since the following scenarios are possible
  - a. Tally is packaged software, on which only a report is customized – which is principal here?
  - b. Oracle is standard database software, with which a customized ERP is developed for a client – which is principal here?
4. This question will have deeper impact if the IT Software goods and IT Services fall under different Rates of GST

Though need for classification of goods/ services is not vital considering one tax regime for all goods and / or services – the classification becomes pertinent when it comes to time of supply, place of supply, and more importantly rate applicability. Hence, though clarity has been provided to a certain extent on classification, guiding principle for taxation would have to be obtained for all software to avoid various interpretations.

#### Amplified compliances:

GST occasions multiple registrations for each place from where supply is made, and consequently sequence of multiple returns, credit pools, refunds, etc. follows. Present tax regime

provides for state wise registration for goods, and centralized registration for services. Government placing administrative ease as against ease of doing business has decided to follow the suit of goods for goods and services tax. National Association of Software and Services Companies (NASSCOM) president R. Chandrashekhkar has already expressed his concern over companies supplying services on a PAN India basis and the number of registrations that it would have to take.

GST being not only a change in rate of tax, would require a complete change in the way of doing business – one time investment in modifying its existing ERP to suit GST would have to be made by all businesses. In terms of being the service provider / software developer for such requirements, there is definitely revenue buoyancy, but similar investment would have to be made for their own business also.

#### Operational snags:

##### 1. Determination of Place of Supply:

GST being a destination based consumption tax, determination of place where the goods/services are supplied is important. The location of the recipient of the services is critical to determine whether it is intra-state supply or inter-state supply. As per subsection (2) of Section 12 of IGST Act, the location of the recipient of the supply is the place of provisioning of services.

- Determining the location of recipient of services as software services are intangible
- In case services are being received at more than one establishment, the establishment that is “most directly concerned” (a highly subjective one) determines the place of supply and is extremely litigation prone.

##### 2. Stock transfer of goods / services:

- These would fall under the ambit of supply as per clause 2 of Schedule I of the CGST Act, 2017 when supplied between distinct persons in the course or furtherance of business even if it is without a consideration. This will have a significant impact on the software companies which has the flexibility to use the resources across the globe depending upon the need of client. Because of this provision, even there is no commercial value to the transaction, the shall be subject GST as long as it is in the course of business or furtherance of business.
- Proviso to clause 2 of the draft Valuation Rules determines the value as per invoice to be taxable value in such cases.
- If employees are deputed in another branch of the same office, invoice would have to be raised for the man hours deployed by the branch having the employee in rolls.

- Development centers in states, other than where the billing centers are located, are covered for the services provided to the billing address.
- Any service provided to a branch office outside India is not covered under 'Export of Service' under Sec 2(6) of IGST Act, 2017 and hence not zero rated. This would lead to the related input tax credit to be reversed by treating the same as Non-taxable rather than being eligible for refund.

### 3. Input tax credits:

- Sec 16 of CGST Act, 2017 provides that every registered person shall be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the **course or furtherance of business**, including any tax paid as Reverse charge as a recipient of supply.
- Present day taxes demand a correlation to be established between the inputs used with the existing business. However, GST provides a leeway even for inputs **intended to be used** not restricting to it to the existing business, but also for **furtherance of business**. To that extent, industry stands to benefit.
- Sec 17 (5) restricts credits that are fully / partially / conditionally disallowed on activities like Rent-a-cab service, insurance, food expenses for its employees which increases the cost and makes India less competitive in the industry already hit by US non-trade restrictions.
- Decentralized registration will lead to skewed credit accumulation that is disproportionate to the output supply leading to a huge working capital deficiencies.

### 4. Continuation of Export/ Special Economic Zone (SEZ) benefits?

- Any provision of supply to a branch or head office outside India will continue to remain outside Zero-rating. Hence, ITC used for such supply would be non-taxable and would not be eligible for refund, hence would have to be reversed.
- Ab-initio exemption of service tax for SEZ units would not be available anymore and would impact adversely the working capital, notwithstanding its subsequent refund.

### 5. Others

- As per subsection (4) of section 9, the registered person is obliged to pay GST under Reverse Charge Basis for all the transactions executed with un registered person. To the extent it will have an impact on the cashflow of the software companies and because of this provision, software companies are indirectly compelled to deal only with the registered person.
- Under the existing regime, the software companies are filing return twice a year based on the centralized registration. However, in the new regime, every branch in each state must

file minimum 3 returns monthly apart from annual return. This will increase the work load and the cost of compliances.

## 6. Conclusion

To conclude, IT(GST) is definitely NOT EASY for IT sector. The administrative complexities along with implementation cannot be disregarded. One just hopes that the authorities make amends to ensure that the transition is as smooth as possible. A Fitting close to this article would be the words of Alan Wilson Watts, a British philosopher, “The only way to make sense out of change is to plunge into it, move with it, and join the dance”.

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