Instruction No. 3/2014

F. No. 178/84/2012 – ITA.1
Government of India,
Ministry of Finance,
Department of Revenue,
Central Board of Direct Taxes

North Block. ITA.I Division
New Delhi, the 14th March 2014

To
All Chief Commissioners of Income-tax/
All Directors Generals of Income-tax

Subject: Issues relating to export of computer software- Direct tax benefits – Clarification – reg

A clarificatory Circular No. 01/2013 dated 17.01.2013 was issued by CBDT to address various contentious issues leading to tax disputes in cases of entities engaged in export of computer software which are availing tax-benefits under sections 10A, 10AA and 10B of the Income-tax Act, 1961.

2. Thereafter, Instruction No.17/2013 was issued on 19.11.2013 to the field authorities advising them to follow the aforesaid Circular in letter and spirit so that the cases which are covered by the above instruction are not contested in further appeal. The objective was to avoid frivolous litigation on issues which stand clarified by the Circular No. 01/2013 dated 17.01.2013.

3. In continuation thereof, the undersigned is directed to convey that the said clarificatory Circular No. 01/2013 dated 17.01.2013 may be brought to the notice of all Departmental Representatives (DRs) and Standing Counsels of the Department who plead such matters before the ITATs and the Courts, respectively so that such appellate authorities/courts are duly appraised of the clarifications issued by CBDT on various contentious issues pending before them.

(Deepshikha Sharma)
Deputy Secretary to the Government of India

Lunawat & Co.
Chartered Accountants
E-mail: ca@lunawat.com, lunawat@vsnl.com.
Website: www.lunawat.com.

CIRCULAR NO. 01/2013,

Dated: January 17, 2013

Subject: Issues relating to export of computer software-Direct tax benefits-Clarification reg.

The Indian Software Industry has been the beneficiary of direct tax incentives under the provisions like Sections 10A, 10AA & 10B of the Income -tax Act, 1961 in respect of their profits derived from the export of computer software. These provisions prescribe incentives to "units" or "undertakings", established under different schemes, which are/were deriving profits from export of computer software subject to fulfilling the prescribed conditions.

2. It has been represented by the software companies that several issues arising from the above mentioned provisions are giving rise to disputes between them and the Income-tax authorities leading to denial of tax benefits and consequent litigation and, therefore, require clarification. Various issues highlighted by the Software Industry have been examined by the Board and the following clarifications ore hereby issued -

(i) (a) WHETHER "ON-SITE" DEVELOPMENT OF COMPUTER SOFTWARE QUALIFIES AS AN EXPORT ACTIVITY FOR TAX BENEFITS UNDER SECTIONS 10A, 10AA AND 10B OF THE INCOME TAX ACT, 1961; AND

(b) WHETHER RECEIPTS FROM DEPUTATION OF TECHNICAL MANPOWER FOR SUCH "ON-SITE" SOFTWARE DEVELOPMENT ABROAD AT THE CLIENTS PLACE ARE ELIGIBLE FOR DEDUCTION UNDER SECTIONS 10A, 10AA AND 10B.

(a) CBDT had earlier issued a Circular (Circular No. 694 dated 23.11.1994) which provided that a unit should not be denied tax-holiday under sections 10A or 105 on the ground that the computer software was prepared 'on-site' at long as it was a product of the unit, i.e.. it is produced by the unit. However, certain doubts appear to have arisen following the insertion of Explanation 3 to sections 10A and 10B (vide Finance Act, 2001) and Explanation 2 to section 10AA (vide Special Economic Zones Act, 2005) providing that "the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India", and a clarification has been sought on the impact of the Explanation on the tax-benefits as compared to the situation that existed prior to the amendments.

The matter has been examined. In view of the position of law as it stands now, it is clarified that the software developed abroad at a client's place would be eligible for benefits under the respective provisions, because these would amount to 'deemed export' and tax benefits would not be denied merely on this ground. However, since the benefits under these provisions can be availed of only by the units or undertakings set up under specified schemes in India, it is necessary that there must exist a direct and intimate nexus or connection of development of software done abroad with the eligible units set up in India and such development of software should be pursuant to a contract between the client and the eligible unit. To this extent. Circular No. 694 dated 23.11.1994 stands further clarified.

Lunawat & Co.
Chartered Accountants
E-mail: ca@lunawat.com, lunawat@vsnl.com.
Website: www.lunawat.com.

(b) It has also been brought to notice that it is a common practice in the software industry to depute Technical Manpower abroad (at the client's place) for software development activities (like upgradation, testing, maintenance, modification, trouble-shooting etc.), which often require frequent interaction with the clients located outside India. Due to the peculiar nature of software development work, it has been suggested that such deputation of Technical Manpower abroad should not be considered detrimental to the benefits of the exemption under sections 10A, 10AA and 10B merely because such activities arc rendered outside the eligible units /undertakings.

The matter has been examined. Explanation 3 to sections 10A and 10B and Explanation 2 to section 10AA clearly declare (hat profits and gains derived from 'services for development of software' outside India would also be deemed as profits derived from export. It is therefore clarified that profits earned as a result of deployment of Technical Manpower at the client's place abroad specifically for software development work pursuant to a contract between the client and the eligible unit should not be denied benefits under sections 10A, 10AA and 10B provided such deputation of manpower is for the development of such software and alt the prescribed conditions are fulfilled.

(ii) WHETHER IT IS NECESSARY TO HAVE SEPARATE MASTER SERVICE AGREEMENT (MSA) FOR EACH WORK CONTRACT AND WHAT EXTENT IT IS RELEVANT.

As per the practice prevalent in the software development industry, generally two types of agreement arc entered into between the Indian software developer and the foreign client. Master Services Agreement (MSA) is an initial general agreement between a foreign client and the Indian software developer setting out the broad and general terms and conditions of business under the umbrella of which specific and individual Statement of Works (SOW) are formed. These SOWs, in fact, enumerate the specific scope and nature of the particular task or project that has to be rendered by a particular unit under the overall ambit of the MSA. Clarification has been sought whether more than one SOW can be executed und«r the ambit of a particular MSA and whether SOW should be given precedence over MSA.

The matter has been examined. It is clarified that the tax benefits under sections 10A, 10AA and 10B would not be denied merely on the ground that a separate and specific MSA docs not exist for each SOW. The SOW would normally prevail over the MSA in determining the eligibility for tax benefits unless the Assessing Officer is able to establish that there has been splitting up or reconstruction of an existing business or non-fulfilment of any other prescribed condition.

(iii) WHETHER RESEARCH AND DEVELOPMENT (R&D) ACTIVITIES PERTAINING TO SOFTWARE DEVELOPMENT WOULD BE COVERED UNDER THE DEFINITION OF "COMPUTER SOFTWARE" STIPULATED UNDER EXPLANATION 2 TO SECTIONS 10A AND 10B.

The definition of "computer software" stipulated under Explanation 2 to sections 10A and 10B includes "any customized electronic data or any product or service of similar nature, as may be notified by the Board....". The CBDT had already issued Notification No. 890(E) dated 26.09.2000 specifying such items. The notification includes Engineering and Design but does not specifically include Research and Development activities related to software development in respect of which clarification has been sought.

Lunawat & Co.
Chartered Accountants
E-mail: ca@lunawat.com, lunawat@vsnl.com.
Website: www.lunawat.com.

After examining the matter, it is clarified that the services covered by the aforesaid Notification, in particular, the 'Engineering and Design' do have the in built elements of Research and Development. However, for the sake of clarity, it is reiterated that any Research and Development activity embedded in the 'Engineering and Design', would also be covered under the said Notification for the purpose of Explanation 2 to the above provisions.

(iv) WHETHER TAX BENEFITS UNDER SECTIONS 10A, 10AA AND 10B WOULD CONTINUE TO REMAIN AVAILABLE IN CASE OF A SLUMP-SALE OF A UNIT/UNDERTAKING.

The vital factor in determining the above issue would be facts such as how a slump-sale is made and what is its nature. It will also be important to ensure that the slump sale would not result into any splitting or reconstruction of existing business. These are factual issues requiring verification of facts. It is, however, clarified that on the sole ground of change in ownership of an undertaking, the claim of exemption cannot be denied to an otherwise eligible undertaking and the tax holiday can be availed of for the unexpired period at the rates as applicable for the remaining years, subject to fulfilment of prescribed conditions.

(v) WHETHER IT IS NECESSARY TO MAINTAIN SEPARATE BOOKS OF ACCOUNT FOR AN ASSESSEE IN RESPECT OF IT SELIGIBLE UNITS CLAIMING TAX BENEFITS UNDER SECTIONS 10A AND 10B.

Since there is no requirement in law to maintain separate books of account, the same cannot be insisted upon. However, since the deductions under these sections are available only to the eligible units, the Assessing Officer may call for such details or information pertaining to different units to verify the claim and quantum of exemption, if so required.

(vi) WHETHER TAX BENEFITS UNDER SECTION 10AA CAN BE ENJOYED BY AN ELIGIBLE SEZ UNIT CONSEQUENT TO ITS TRANSFER TO ANOTHER SEZ.

This issue relates to cases where an eligible SEZ unit is shifted from one SEZ to another SEZ on account of commercial exigencies. This shifting is permissible under Instruction No.59 (F.No.C-4/2/2010-SEZ) issued by Department of Commerce (SEZ Division), provided approval from the Board of Approvals (BOA) has been obtained. Doubts have been raised whether such shifting of an eligible unit would deprive the unit/undertaking of tax benefits, provided there is no splitting or reconstruction of an existing business.

The matter has been examined and it is clarified that the tax holiday should not be denied merely on the ground of physical relocation of an eligible SEZ unit from one SE2 to another in accordance with Instruction No. 59 of Department of Commerce (referred to above) and if all the prescribed conditions are satisfied under the Income-tax Act, 1961. It is further clarified that the unit so relocated will be eligible to avail of the tax benefit for the unexpired period at the rates applicable to such years.

(vii) WHETHER NEW UNITS/UNDERTAKINGS SET UP IN THE SAME LOCATION WHERE THERE IS AN EXISTING ELIGIBLE UNIT/UNDERTAKING WOULD AMOUNT TO EXPANSION OF THE EXISTING UNIT/UNDERTAKING.

Whether setting up of new unit/undertaking in a location (covered by sections 10A, 10AA or 10B), where an eligible unit is already existing, would amount to expansion of such already existing unit is a matter of fact requiring examination and verification. However, it is clarified that setting up of such a fresh unit in itself would not make the unit ineligible for tax benefits, as long as the unit is set-up after obtaining necessary approvals from the competent authorities: has not been formed by splitting or reconstruction of an existing business; and fulfils all other conditions prescribed in the relevant provisions of law.

3. The above may be brought to the notice of all concerned.

F.No.178/84/2012-ITA.I

(Surabhi Sharma)
Under Secretary (ITA.I)

Instruction No. 17/2013

(F.NO.178/84/2012-ITA.I) dated 19.11.2013

A clarificatory Circular No. 01/2013, dated 17-1-2013 (hereinafter referred to as 'Circular') was issued by CBDT to address various contentious issues leading to tax disputes in cases of entities engaged in export of computer software which are availing tax-benefits under sections 10A, 10AA and 10B of the Income-tax Act, 1961.

2. Instances have been reported where the Assessing Officers are not following the clarifications so issued and are taking a divergent view even in cases where the clarifications are directly applicable.

3. The undersigned is directed to convey that the field authorities are advised to follow the contents of Circular in letter and spirit. It is also advised that further appeals should not be filed in cases where orders were passed prior to issue of Circular but the issues giving rise to the disputes have been clarified by the Circular

Lunawat & Co.
Chartered Accountants
E-mail: ca@lunawat.com, lunawat@vsnl.com.
Website: www.lunawat.com.