

# Information Technology Software Service: Issues in Service Tax

The ambiguity over the issue whether IT/computer software is *goods or services* was partly resolved by the Supreme Court's decision in the TCS case, where the court held that 'Off-the-shelf software' or packaged software qualifies as 'goods', and 'Made-to-order' software or customised software may also qualify as 'goods' and certain tests were laid down.

Subsequently, a new taxable service category of 'Information Technology Software Services' (ITSS) was introduced by the Finance Act, 2008. Software related services which were earlier sheltered from the levy of Service Tax were brought under the Service Tax net, following which debates surrounding IT software have once again been thrown open.

Under the definition of the taxable service of ITSS, the following services in relation to IT software, provided for use or in furtherance of business or commerce, have been made taxable. These included development, study, analysis, design and programming, adaptation, upgradation, enhancement, implementation, and other similar services; advice and assistance on related matters, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the start-up phase, etc.; acquisition of right to use IT software for commercial exploitation including the right to reproduce, distribute; sell and acquire; right to use IT software, supplied electronically.

### Spotlighting the key issues

As per the Finance Minister's speech during the budget presentation and a clarification issued by the Ministry

of Finance, it appears that the intention behind the introduction of ITSS was to tax the supply of customised software only. However, the definition of IT software in the Service Tax legislation is worded broadly enough to include both packaged and customised software within its ambit. The Ministry's intention to levy Service Tax only on the supply of customised software does not seem to manifest itself in the law.

Many states are levying VAT on the transfer of 'right-to-use' of both packaged and customised software. The same transaction would also be taxed under the Service Tax legislation. Thus, a dealer trading in software and charging VAT could also be brought under the Service Tax net on account of 'commercial exploitation' of IT software. This would lead to double-taxation and passing of both the VAT and the Service Tax burden to the consumer.

ITSS also brings under the Service Tax net, the acquisition of the 'right-to-use' IT software supplied electronically. This is contrary to the industry practice where transfer of 'right-to-use' software is treated as sale of goods, immaterial of the mode of supply of software.

A silver lining is that software exporters may now claim a refund of Service Tax paid on input services used in the export of services, since IT services have now been given a status of 'taxable' services. However, a concerted effort from the centre and the states to clearly identify transactions for Service Tax and VAT would provide the much needed confidence to the IT industry.

Contributed by Ernst & Young

# UK's New Points Based System (PBS)

The UK, an important partner for the Indian IT-BPO industry has introduced a new work permit system to bring in rightly skilled professionals from other countries.

The objective of the UK Government, under the broad heading of 'managed migration', is to boost Britain's economy by bringing the right skills into the UK from around the world and ensuring the UK is easy to visit, legally.

In February 2008, a new points-based system was introduced in the UK to ensure that only those with the right skills or the right contribution will be able to come to the UK to work and study. The key elements of the system are:

- **Simplicity** – it combines more than 80 pre-existing work and study routes in to the UK into five tiers
- **Flexibility** – points are awarded on workers' skills to reflect aptitude, experience, age and also the demand for those skills any given sector, to allow the UK to respond flexibly to changes in the labour market
- **Transparent** – it is a fair, transparent and objective system that will enable potential migrants to assess their likelihood of making a successful application and should help to reduce the number of failed applications

## Tier-2 and ICTs

Underpinning the new immigration system is a five-tier framework, where Tier-1 covers highly skilled individuals who contribute to growth and productivity and Tier-2 is constituted by skilled workers with a job offer to fill gaps in the UK's labour force. Typically, the vast majority of employees in the IT/BPO sector coming into the UK fall into the Tier-2 category.

Under the existing work permits system, NASSCOM member companies have typically been using Intra-Company Transfers (ICTs) to move employees from India to the UK for short periods, and a provision has been made for ICTs as a discreet category within Tier-2 of the PBS.

## Issuing an ICT work permit under Tier-2

Today, a three-stage process enables companies to issue ICT work permits under Tier-2 and gain permission from the UK Government to transfer an employee to the UK. An important point to note is that it is the UK entity which must apply for a licence to sponsor and not the parent entity in India. Once an employer is registered as a sponsor it must check that migrants score a total of at least 60 points across the different criteria before issuing their certificate of sponsorship through the online sponsorship management system.

## Gaining permission to enter/stay in the UK

The sponsor register for employers for Tier-2 opened on July 28, 2008 and is expected to 'go live' for Tier-2 on November 24, 2008. The UKBA is currently considering a cut-off date of October 1 for applications to become sponsors. If companies miss the cut-off or 'go live' dates, and are not on the sponsor's register, they will not be able to bring people into the UK on ICTs.

**In order to apply for a licence to sponsor, please visit <https://www.points.homeoffice.gov.uk>**

| Criteria for points  | What UKBA awards points for   | Points awarded |
|--|---|----------------|
| <b>Intra-Company Transfer</b><br>– 30 points available     | Points will be awarded if migrant has been working for the overseas branch of that organisation for at least six months; job is S/NVQ3 skill level or above; migrant will be paid the appropriate salary rate for the job | 30             |
| <b>Qualifications</b><br>– up to 15 points available       | S/NVQ level 3   | 5              |
|  | Bachelor's or master's degree   | 10             |
|  | PhD   | 15             |
| <b>Prospective earnings</b><br>– up to 20 points available | £17,000 - £19,999   | 5              |
|  | £20,000 - £21,999   | 10             |
|  | £22,000 - £23,999   | 15             |
|  | £24,000+  | 20             |
| <b>Maintenance requirement</b><br>– 10 points available    | £800 if the migrant is applying from inside the United Kingdom; £800 if the migrant is applying from outside the United Kingdom, £533 for each dependant – exact figures subject to change                                | 10             |
| <b>English language skills</b><br>– 10 points available    | If migrant is a national of a majority English speaking country or has passed an English language test or has a degree taught in English  | 10             |