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Clarification on direct tax benefits relating to export of computer software

In brief

The Central Board of Direct Taxes (CBDT) has issued Circular no. 01/2013 to clarify on issues regarding the direct tax incentives under sections 10A, 10AA and 10B of the Income-tax Act, 1961 (the Act) relating to export of computer software. The questions addressed pertain to on-site development of computer software, relevance of master service agreement, research and development activities relating to software development, applicability of relevant provisions in the case of slump sale, availability of tax benefits on transfer of an eligible Special Economic Zone (SEZ) unit to another SEZ and availability of tax benefits on setting-up a new industrial unit in the same location of the eligible unit.

On-site development of computer software qualifies as an export activity

The CBDT Circular no. 694 dated 23 November 1994 and Explanations to sections 10A, 10B and 10AA of the Act provide that profits and gains derived from on-site development of computer software outside India shall be deemed as derived from outside the country. Further, it has been clarified that software developed abroad at a client's place will be eligible for tax benefits if a contract exists between the client and the eligible unit and a direct and intimate nexus exists between the development of software abroad and the eligible units set up in India.

Receipts from deputation of technical manpower for on-site software development abroad is eligible for deduction

Profits derived from deputation of technical manpower abroad pursuant to a contract between the client and the eligible unit for software development activities which are rendered at a client's place abroad should be eligible for deduction under sections 10A, 10AA and 10B of the Act provided that the deputation is for development of software and all the prescribed conditions are fulfilled.

Relevance of a separate master service agreement for each work contract

Master service agreement (MSA) is the general agreement between the foreign client and the Indian software developer which defines the broad terms and conditions of business under which specific and individual scope of work (SOW) is entered into. It has been clarified that benefits under sections 10A, 10AA and 10B of the Act shall be available even though a separate and specific MSA does not exist for each SOW. The SOW would prevail over the MSA to determine the eligibility of tax benefits provided that all the prescribed conditions are fulfilled.

Research and development activities will be covered under the definition of 'computer software'

Notification no. 890(E) dated 26 September 2000 issued by the CBDT specified engineering and design activities to be included in the definition of computer software as stipulated in Explanation 2 to section 10A and 10B of the Act. The CBDT has now clarified that any research and development activity embedded in 'engineering and design' will also be covered by the aforesaid Notification for the purpose of Explanation 2 to section 10A and 10B of the Act.

Availability of tax benefits in case of slump sale

It has been clarified that in case of a slump sale of a unit, purely because of change in the ownership, the claim of exemption will not be denied to an otherwise eligible undertaking and the tax holiday can be availed for the unexpired period at the rates as applicable for the remaining years. The nature of slump sale needs to be determined and it should be ensured it does not result into splitting or reconstruction of an existing business.

Necessity to maintain separate books of account in respect of an eligible unit

It has been clarified that as per law separate books of account for units claiming tax benefits need not be maintained. The assessing officer might call for details or information pertaining to different units to verify the claim and quantum of exemption eligible under sections 10A, 10AA and 10B of the Act.

Availability of tax benefits on transfer of an eligible SEZ unit to another SEZ

Where an eligible SEZ unit is transferred to another SEZ unit due to commercial exigencies and there is no splitting or reconstruction of an existing business, it has been clarified that tax benefits will not be denied merely due to physical relocation of an eligible SEZ unit from one SEZ to another. The relocated unit will be eligible to avail the tax benefits for the unexpired period at the applicable rates.

Availability of tax benefits on setting-up of a new industrial unit in the same location of an eligible unit

It has been clarified that setting-up of a fresh unit where an eligible unit is already existing will not make the unit ineligible for tax benefits, as long as the unit is set up after obtaining necessary approvals from the competent authorities. However, the unit should not be formed by splitting or reconstruction of an existing business and all other conditions prescribed in the relevant provisions of law should have been fulfilled.

Conclusion

There are many disputes pending resolution as tax holiday available on export of software services were denied on various grounds. This circular is an extremely welcome move by the CBDT and could be seen as an initiative to improve investment sentiment. Many IT companies would benefit from this Circular.

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