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CLARIFICATION REGARDING ISSUES RELATING TO EXPORT OF COMPUTER SOFTWARE- DIRECT TAX INCENTIVES

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Following is the text of the Statement made by the Chairperson, CBDT to the media here today:

"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.

It was 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, required clarification. In order to address various issues in this regard, the Government had constituted a Committee under the Chairmanship of Mr. N. Rangachary, former Chairman CBDT and IRDA, which was formally notified on 03.08.2012. The Committee, while examining these issues interacted with various Departments of Central Government, industry stakeholders and accounting firms.

The First Report of the Committee was submitted on 14.09.2012 to the Finance Minister and pertained to 'Taxation of Development Centre and IT Sector'. The report, *inter alia,*discussed various Direct Tax issues pertaining to the computer software industry, which are eligible for Direct Tax benefits under sections 10A, 10AA and 10B.These wereexamined inCBDT and the following clarifications are hereby issued -

S.No.	Issue	Clarification
1.	A) Whether "on-site" development of computer software qualifies as an export activity for tax benefits under sections 10A, 10AA and 10B of the it act 1961; and B) Whether receipts from deputation of technical manpower for such "on-site" software development abroad at the client's place are eligible for deduction under sections 10A, 10AA and 10B.	A) 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 B) Explanation 3 to sections 10A and 10B and

		Explanation 2 to section 10AA clearly declare that 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 all the prescribed conditions are fulfilled.
2	Whether it is necessary to have separate Master Service Agreement (MSA) for each work contract and to what extent it is relevant.	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 does 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.
3	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.	It is clarified that the services covered by the 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.
4	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.
5	Whether it is necessary to maintain separate books of account for an assessee in respect of its eligible units	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

	claiming tax benefits under sections 10A and 10B.	may call for such details or information pertaining to different units to verify the claim and quantum of exemption, if so required.
6	Whether tax benefits under section 10AA can be enjoyed by an eligible SEZ unit consequent to its transfer to another SEZ.	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 SEZ to another in accordance with Instruction No. 59 of Department of Commerce 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.
7	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.

The recommendations of the Committee in its first report, pertaining to other issues concerning Development Centres and its subsequent two reports on Safe Harbour provisions for IT and ITES sector and Safe Harbour issues for outbound loans and corporate guarantee are under examination."

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