Business Processing Offices & Call Centres: Impact of levy of Fringe Benefit Tax'

[Circular No.8/2005 of the C.B.D.T. is incorrect in this regard]

278 ITR (Jour) page 25

By: S.K. Tyagi

The Central Board of Direct Taxes (CBDT) has come out with Circular No.8/2005, dated 29.8.2005, providing Explanatory Notes & clarifications in respect of the provisions of Fringe Benefit Tax(FBT), which have been newly introduced, vide Finance Act, 2005. In my earlier Article on '*Fringe Benefit Tax – ambiguities explained and doubts resolved*' [published in 276 ITR (Jour.) page 1], I have already stated that the provisions contained in Chapter XII-H, relating to FBT, have not been properly drafted. The aforesaid Circular has added further confusion, uncertainities and ambiguities in relation to the interpretation of the various FBT provisions.

Vide the aforesaid Circular, as many as 107 frequently asked questions (FAQs) have been answered. Question No.105 relates to the meaning of the term '*Computer software'*. As per answer to Question No.105, it has been stated that I.T. enabled services will not fall within the scope of the term '*Computer software*', for the purposes of Section 115WC of the Income-Tax Act, 1961 (the Act). As per Section 115WC(2), a preferential / special rate of 5 per cent has been prescribed for the computation of fringe benefits(FB), instead of 20 per cent, in respect of the following types of businesses-

(a) Business of hotel

(b) Business of construction

(c) Business of manufacture or production of pharmaceuticals

(d) Business of manufacture or production of computer software

(e) Business of carriage of passengers or goods by motor car, and

(f) Business of carriage of passengers or goods by aircraft.

It may be seen from the provisions of 115WC(2)(d) of the Act that in the case of an employer engaged in the business of manufacture or production of computer software, the value of fringe benefits for the

purposes referred to in clauses (F) & (G) of Section 115WB(2), shall be five per cent instead of twenty per cent referred to in Section 115WC(1)(c) of the Act. Therefore, if as clarified in the aforesaid Circular of the CBDT, the BPO and Call Centre operations and other I.T. enabled services are not covered under the term '*Computer software*', then the value of the relevant fringe benefits shall be taken at twenty per cent instead of five per cent in respect of the employers engaged in such business operations.

According to me, the clarification provided in answer to Question No.105 of the aforesaid Circular of the CBDT that Information Technology or IT enabled services will not fall within the scope of '*Computer software*' for the purposes of Section 115WC, is not correct. The reasons for the same are as follows-

1. **The definition of the term 'Computer software' is provided under other provisions of the Income-Tax Act**

   There is no specific definition provided under the provisions of FBT in respect of the term '*Computer software*'. However, the definition of the aforesaid term has been provided elsewhere in the Act, viz.

   (i) Explanation 2 (i) to Section 10A

   (ii) Explanation 2 (i) to Section 10B, and

   (iii) Explanation (b) to Section 80HHE

   The definition of the term '*Computer software*' under all the aforesaid sections is the same viz. '*Computer software*' means –

   (a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or

   (b) any customized electronic data or any product or service of similar nature, as may be notified by the Board,

   - which is transmitted or exported from India to any place outside India by any means.

In this context, the CBDT has issued a Notification No.11521, dated 26.9.200, which is reproduced as follows-

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NOTIFICATIONS

INCOME-TAX

Notifications under s.10A, Expln.2(i) (b), s.10B, Expln.2(i)(b) & s.80HHE, Expln.(b) of the IT Act,1961

Notification No.11521, dt. 26th Sept., 2000

In exercise of the powers conferred by clause (b) of item (i) of Explanation 2 of section 10A, clause (b) of item (i) of Explanation 2 of section 10B and clause (b) of Explanation to section 80HHE of the Income-Tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby specifies the following Information Technology enabled products or services, as the case may be, for the purpose of said clauses, namely:

(i) Back-office Operations
(ii) Call Centres;
(iii) Content Development or Animation;
(iv) Data Processing;
(v) Engineering and Design;
(vi) Geographic Information System Services;
(vii) Human Resource Services;
(viii) Insurance Claim Processing;
(ix) Legal Databases;
(x) Medical Transcription;
(xi) Payroll;
(xii) Remote Maintenance;
(xiii) Revenue Accounting;
(xiv) Support Centres; and
(xv) Web-site Services.

[F.No.142/49/2000-TPL]

From the aforesaid Notification, it is quite clear that the various IT enabled products or services have been included in the definition of the term '*Computer software*'. It may also be stated that back-office operations and call centres are on top of the aforesaid list.

2. In the absence of definition of the term 'Computer software' in Section 115WC(2), the definition given elsewhere in the Act, will be applicable

In the absence of any definition provided under the provisions of FBT, in respect of the term '*Computer software*', the definition provided in respect thereof, elsewhere in the Act, will have to be applied. For this proposition, reliance is placed on the following reasons / legal precedents.

(i) As per Section 115WL of Chapter XII-H, dealing with FBT, save as otherwise provided in this Chapter, all other provisions of this Act, as far as may be, apply in relation to fringe benefits also.

It is, therefore, evident that in the absence of any definition of the term '*Computer software*', in Chapter XII-H, the definition for the same provided elsewhere in the Act, will apply.

(ii) Generally, a word '*defined*' carries the same meaning throughout the Act, unless it comes within an exception – *Shital Rai Vs. State of Bihar, AIR 1991 Pat.110 (FB).*

As per the aforesaid judgement, the definition of the term '*Computer software*', as provided under Sections 10A, 10B and 80 HHE, will apply in respect of Chapter XII-H in the absence of any definition of the same therein.

(iii) Definition in one section of an Act can be used for the purposes of another section, unless the context indicates otherwise – *CIT Vs. G.S. Atwal & Co. [2002] 254 ITR 592 (Cal.)*

(iv) In this context, it may also be stated that the Andhra Pradesh High Court in the case of *CWT Vs. SB Z.N. Sayeeda [2003] 184 CTR 596 (A.P.)*, has gone to the extent of laying down that provisions of two Acts can be read together when the same are complementary to each other.

(v) As per the judgement in the case of *CIT Vs. Nathan Mining Works [2005] 274 ITR 149 (Mad.)*, in case of doubt regarding the meaning of a term in taxing statutes, the interpretation in favour of the assessee should be adopted.

(vi) In answer to Q.No.64 in the aforesaid Circular, it is stated , "The term 'sales promotion and publicity' has not been defined in the Act and hence it should be given its natural meaning".

It clearly implies that in the absence of definition of a term, its definition provided elsewhere in the Act, will apply.

3. Section 115WC(2) grants incentives in favour of certain businesses and therefore, the same must be liberally construed

As already explained, Section 115WC(2) provides a lower percentage for the valuation of fringe benefits for the purposes of various clauses of Section 115WB(2) in the case of employers engaged in the businesses covered thereunder.

The Finance Minister in his speech in Parliament on 5.5.2005, while introducing amendments to Finance Bill, 2005, has stated as follows-
'*We have lowered the base rates sharply to 20 per cent in most cases except four cases where it is 50 per cent and for special sectors like pharma and software and travel agencies, we have lowered the base even further to 5 per cent*' – 145 Taxman (St.) 31.

From the aforesaid facts, it is quite evident that the valuation of fringe benefits for certain businesses has been prescribed at a lower rate of 5 per cent instead of 20 per cent, in order to grant special treatment or incentive to the same. In other words, it may be stated that Section 115WB(2) provides an incentive as well as benefit in respect of special sectors, stated therein.

There are a number of legal precedents which favour liberal interpretation in respect of incentive and beneficial provisions. In this context, the following rules of interpretation are quite relevant.

(i) Incentive provision is to be liberally construed

For this purpose, reliance may be placed on the judgement of the Apex Court, in the case of *Bajaj Tempo Ltd. Vs. CIT* [1992] 196 ITR 188 (SC). This judgement deals with erstwhile Section 15C(2)(i) of the 1922 Act, which is akin to present Section 80-IA. The relevant part of the head note on p.189 of the Report, is reproduced, as follows:

" *A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally; and since a provision for promoting economic growth has to be interpreted liberally, the restriction on it too, has to be construed so as to advance the objective of the provision and not to frustrate it.***"**

From the aforesaid judgement of the Apex Court, it is clear that an incentive provision should be construed liberally so as to advance the objectives of the provision, like Section 80-IB of the Act.

(ii) Purposive construction – Intention

A purposive approach for interpreting the Act is necessary. The courts must look to the object, which the statute seeks to achieve while interpreting any of the provisions of the Act. For this proposition, reliance may be placed on the following judgements:

- *S.Gopal Reddy Vs. State of Andhra Pradesh* JT 1996 (6) SC 268
- *K.P. Varghese Vs. ITO* [1981] 131 ITR 597 (SC)
- *Indian Hotel Co. Ltd. Vs. ITO* [2000] 245 ITR 538 (SC)

From the aforesaid judgements, it is clear that the provisions of taxing statute have to be construed in a manner that the objective / purpose of the enactment is really achieved.

(iii) A beneficial provision is to be interpreted liberally and in favour of the assessee

As per the judgement in the case of *CIT Vs. Gujarat Aluminium Extrusions Pvt. Ltd. [20003] 263 ITR 453 (Guj.)*, it is settled legal position that provision for exemption or relief should be construed liberally and in favour of the assessee.

Similar is the view taken in the case of *A.S.Mani Vs. Union of India [2003] 264 ITR 5(Karn.)*

(iv) Ambiguity is to be resolved in tax-payer's favour

The Supreme Court has held that ambiguity in interpretation has to be resolved in favour of the tax-payer. This was held by the Apex Court in the case of *CIT Vs. Kulu Valley Transport Co. Pvt. Ltd.* [1970] 77 ITR 518 (SC). Besides, the view that the benefit of doubt as to interpretation of law should go to the tax-payer is now well established, as held in the cases of

(a) CIT Vs. Madhav Prasad Jatia [1976] 105 ITR 179 (SC)
(b) CIT Vs. Vegetable Products Ltd. [1973] 88 ITR 192 (SC)

(v) In case of two possible views, a view beneficial to the assessee is to be preferred

In case of two possible views, a view beneficial to the assessee is to be preferred. The aforesaid proposition is supported by the following judgements-

(a) *CIT Vs. LG. Balakrishnan [2002] 176 CTR 118 (Mad.)*

(b) K.V. Kader, CIT Vs. A.J. Abraham Anthraper [2004] 268 ITR 417 (Ker.)

From the aforesaid principles of interpretation of taxing statutes, as laid down by the Apex Court and High Courts, it is evident that an incentive provision for the encouragement and growth of economy should be liberally interpreted in a manner that the purpose and objective of the enactment are achieved. Besides, a beneficial provision is also to be interpreted liberally and in favour of the assessee. In addition, in case of an ambiguity or two possible views also, a view beneficial or favourable to the assessee is to be preferred.

In view of the aforesaid reasons, the term '*Computer software*', as contemplated in Section 115 WC(2)(d) of the Act, must be construed liberally and in favour of the assessees.

4. The processing of data through computers is considered as manufacture or production of computer software

As per Section 115WC(2)(d) of the Act, a lower percentage of 5 per cent instead of 20 per cent, for the valuation of fringe benefits for the purposes referred to in clauses (F) and (G) of Section 115WB (2) of the Act, in case of an employer engaged in the business of manufacture or production of computer software, is to be adopted.

In this context, it may be stated that as per a number of judgements, data processing on behalf of clients is considered as manufacture or production of computer software. The same are as follows-

(i) CIT Vs. Peerless Consultancy & Services Pvt. Ltd. [2001] 248 ITR 178 (S.C.)

In this case, the issue before the Apex Court was whether the assessee engaged in the business of processing of data on behalf of its clients, was an industrial company entitled to investment allowance.

It was held that the assessee was an industrial company entitled to investment allowance. It may be stated here that an industrial company is one which is engaged in the manufacture or production of goods or articles or computer software, etc.

(ii) Hyderabad Industries Ltd. Vs. CIT [2002] 172 CTR 413 (A.P.)

In this case, the issue before the High Court was whether data processing machine is entitled to investment allowance.

It was, *inter-alia*, held that processing of data was production of an article or thing and therefore, the assessee was entitled to investment allowance.

(iii) CIT Vs. Technotive Eastern Pvt. Ltd. [2002] 255 ITR 253 (Gau.)

In this case also the assessee engaged in the business of data processing through computers was held to be an industrial undertaking and accordingly, it was entitled to deduction under Section 80HH and 80-I of the Act.

5. The interpretation of the term 'Computer software' in the aforesaid Circular is not correct

In view of the aforesaid reasons, the meaning of the term '*Computer software*' as explained in answer to Question No.105 of the aforesaid Circular of the CBDT, is absolutely incorrect. It appears, that while answering the aforesaid Question No.105, the other aspects related to the issue as brought out earlier in this Article, were not considered.

It may also be relevant in this context to state that the exemption provided under Section 10A and 10B and deduction under Section 80 HHE of the Act, have been provided in order to encourage export of computer software and computer software industry in general. It is, on account of this reason that a preferential / special treatment has been accorded to the employers engaged in the business of manufacture or production of computer software, under the provisions of FBT. For this very reason, the Notification No.1151, dated 26.9.2000, including the I.T. enabled products or services must be treated as part of definition of '*Computer software*', as contemplated under Section 115WC(2)(d) of the Act.

6. Whether a Circular of the CBDT is binding on the tax-payer / assessee

In this connection, it may also be relevant to deal with the issue as to the extent a Circular of the CBDT is binding on the tax-payer / assessee. In this context, we will have to examine the provisions of Section 119(2) of the Act. The CBDT has been empowered, under Section 119 (1) of the Act, to issue such orders, instructions directions to other I.T. authorities as it may deem fit for the proper administration of the Act and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the CBDT. Under Section 119 (2), however, it has been laid down that the Board may issue direction

for the purpose of proper and efficient management of the work of assessment and collection of revenue, provided the instructions are not prejudicial to the assessee.

Therefore, any instruction to be issued by the Board should not adversely affect the interests of the assessees. If such directions are issued then they have to be held *ultra vires* the scope of Section 119(2) of the Act.

The aforesaid proposition is supported by the judgement of Madras High Court in the case of *Madura Coats Vs. Dy. CIT [2005] 195 CTR 138 (Mad.)*

From the aforesaid judgement of the Madras High Court and the provisions of Section 119(2) of the Act, it is quite clear that a Circular of the CBDT is not, at all, binding on the assessee / tax-payer.

7. Conclusion

From the aforesaid discussion, it may be concluded –

(i) The clarification issued by the CBDT, vide answer to Question No.105 of Circular No.8/2005, is absolutely incorrect.

(ii) The term '*Computer software*', as contemplated under Section 115WC(2)(d) of the Act, includes within its scope all IT enabled products and services such as BPOs and Call Centres, etc.

(iii) The value of fringe benefits in respect of the business of manufacture or production of '*Computer software*' relating to clauses (F) and (G) of Section 115WB(2), shall be taken at 5 per cent instead of 20 per cent, and

(iv) The aforesaid clarification issued by the CBDT is not, at all, binding on the assessee / tax-payer.

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