Technology

Union Budget 2017-18

Post-Budget sectoral point of view

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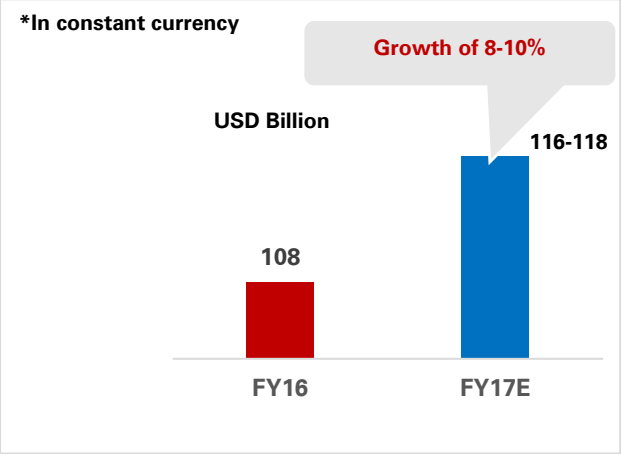
Setting the context

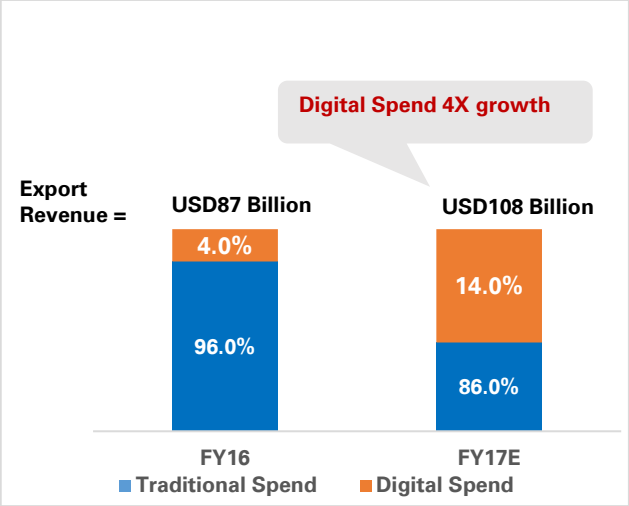
Where are we

Indian IT-BPM Exports



Source: NASSCOM Mid Year performance review of IT-BPM 2016

Indian IT-BPM Exports shared by segments



Source: NASSCOM Mid Year performance review of IT-BPM 2016

- IT–BPM (Business Process Management) industry is projected to achieve USD350 billion[1] by 2025
- IT-BPM industry is expected to grow only at 8-10 per cent[1] in constant currency during Finance Year [FY] 2017 due to theslowdown in IT spends by Banking, financial services and insurance (BFSI), global political and economic uncertainties and currency volatility
- However, IT – BPM export revenue continues to gain market share and stands at 7 percent[1] of global software and IT services spend and outsources 57 percent[1] of global IT services
- Out of all the deals made in January to July 2016, 43 percent[2] were made around Social, mobile, analytics and cloud (SMAC), blockchain, IoT (Internet of things) and automation
- Digital solutions forms 14 percent[2] of IT-BPM revenues but the sector needs skilled workforce to meet anticipated growth in digital solutions
- BPaaS (Business process as a service), mobility and advanced analytics are key drivers for BPM exports
- The U.K. and the U.S. combined form 80 per cent[4] of the Indian IT - BPM export market
- India, with over 1000 centres[3] focused on technology, Research & Development ['R&D'] service, is the biggest Global In-House centre (GIC) location worldwide
- India is home to the third largest start-up ecosystem with over 4,750 firms[3]
- There were expectations from domestic market to grow at over 3 per cent to reach USD35 billion (excluding e-commerce) in FY16[4]

[1] IT industry went through peaks and lows during 2016 : BVR Mohan Reddy, Indiainfoline, accessed on 31 January 2017
[2] IT-BPM Industry in India – Revised, Nasscom, 16 November 2016
[3] Mid-year performance review of the IT-BPM industry by NASSCOM, NASSCOM, accessed on 31 January 2017
[4] Strategic Review 2016, IT-BPM Sector in India, Nasscom,2016

- Domestic market is creating opportunities around digital enterprise, connected consumer and government spending.
- The Indian E-commerce market is expected grow from USD30 billion in 2016 to USD120 billion in 2020[5].

Key issues/challenges

- The Indian IT–BPM industry has been traversing through various challenges. The ambit of reasons, including protectionism in the global market, perplexed political scenario, visa regulations and the emergence of new technologies, have added to the challenges. The IT services sector has been facing the brunt of pressing issues, such as pricing pressure, decrease in IT spending patterns and the average deal size getting smaller
- With the digital disruption, global companies are shifting towards digital services and cloud computing. These companies are looking for high-value propositions and innovative solutions, rather than what was provided by the Indian companies traditionally. With the shift towards digital, Indian companies are lagging behind in upskilling their employees for 'high-value' work and new-age technologies
- While the emerging technologies have created opportunities on the one hand, they have also given rise to uncertainties on the other; automation and Artificial Intelligence (AI)-based platforms are replacing processes dependent on human input to a significant extent.

Government's stance

- The country has launched the new Intellectual Property Right (IPR) policy in May 2016 to foster innovation, increase predictability, clarity and transparency in India's IP regime. The new IPR policy is expected to help in effective protection of patents that can encourage MNCs to launch their products in India6
- In 2016, national capital goods policy was announced, aiming to facilitate improvement in technology depth across sub-sectors, increase skill availability, ensure mandatory standards and promote growth and capacity building of MSMEs7
- Under the automatic route, 100 percent Foreign Direct Investment (FDI) is permitted in the manufacturing items[8].

Expectations

- **Policy and regulatory**
  - Policy measures to enhance digital literacy, improved connectivity and access to technology, in line with the government's intention to move towards a cashless economy
  - A single-window mechanism for Small and Medium Enterprises (SMEs) and start-ups for all business-related compliances, with provisions for time-bound clearances
  - Greater clarity on the sector's contribution towards 'Digital India', 'Smart Cities Mission' and 'Make in India' initiatives.
- **IT-ITeS**
  - There is a need to improve the broadband connectivity in India, create a better underground fibre cable network and improvise over-ground towers

[5] India – eCommerce, Export, accessed on 31-Jan-2017
[6] Cabinet approves National Intellectual Property Rights Policy", Press Information Bureau Government of India Cabinet, 13 May 2016
[7] Govt. unveils National Capital Goods policy during the 'Make in India Week', TheHindu, 15 February, 2016
[8] Electronics & IT sector Achievements Report, DeiTY, 8 November, 2016

- With a push towards digital literacy, there is a need for improved connectivity and access to technology by radical government re-engineering and larger budgetary allocation for such initiatives[9]
- Intellectual Property (IP) need special expertise and, hence, a separate bench could be set up to resolve matters related to IP issues
- With robotics going into the mainstream, incentives can be given to boost the technology. Currently, no such incentive is given
- Due to the rapidly changing nature of technology, it has become equally important to focus on research and development (R&D) in the technology sector. Hence, the government needs to promote R&D and provide incentives for this. Currently, R&D incentives are only provided to non-IT sectors.

- **Electronics manufacturing**
  - To boost local electronic manufacturing in the country, the differential duty scheme could be extended to other categories of ITA goods, including laptops, desktops, e-readers and networking switches[10]
  - There is a need to encourage populated printed circuit board (PCB) manufacturing in the country by restricting their direct imports.

- **Start-ups**
  - Introduce a single window mechanism for start-ups for all business related compliances, with provisions for time-bound clearances.

- **Digital payments**
  - Additional measures could be taken to encourage digital payments, for example, by retreating charges levied on digital payments and also mandating government departments to include options for digital payments[11]
  - The government needs to invest in advanced technological infrastructure that can help ensure seamless transactions and improve the overall banking system
  - The promotion of definitive standard operating procedures (SOPs) and tax rebates would encourage and boost e-payments in the country.

- **Direct taxes**
  - Defer implementation of Place of Effective Management (POEM) provisions to 1 April 2017 and increase the current tax benefits threshold of INR3 crore to a higher amount for applicability of General Anti-Avoidance Rule (GAAR)
  - Exempt start-ups from taxes, such as Minimum Alternate Tax (MAT) and concessions for employee stock option plans (ESOP)
  - Reduce the rate of equalisation levy (currently at 6 percent) owing to lower margins of digital companies, most of them being start-ups facing losses in initial years
  - Provide the way forward on the Base Erosion and Profit Shift (BEPS) action plan, viz., digital taxation, multi-lateral instruments, etc., and incentivise digital payments
  - Lower the long-term capital gains (LTCG) tax rate for domestic investors to 10 percent for sale of unlisted shares of start-ups
  - Extend weighted deduction for R&D expenses and skill development expenses to the software sector and extend carry-forward of losses/depreciation upon corporate mergers

[9] Countdown to Budget 2017: Expectations for Information Technology sector, Forbes, 23 January, 2017
[10] Countdown to Budget 2017: Expectations for Information Technology sector, Forbes, 23 January, 2017
[11] Watal panel suggests incentives, regulator for digital payment, India Today, 27 December, 2016

— Increase the current salary ceiling of INR25,000 per month for deduction under section 80JJAA

— Redefine the transfer pricing safe harbour margins for adoption by SMEs in the technology sector, since the current margins of 20 percent to 30 percent remains ineffective.

- **Indirect taxes**

— Clarity on the GST law relating to levy of cess, credits, exemption threshold, place of provisioning of service, treatment of intangibles, such as software

— Clarity on e-commerce taxation w.r.t. service tax on aggregators, dual levy of Value Added Tax (VAT) and service tax on delivery charges of goods, etc.

— Introduce taxpayer-friendly schemes for quicker disposal of service tax refund claims

— Introduce schemes, such as lower customs duty on import of raw materials used in the manufacturing of hardware products, higher drawback, and additional benefit under the Foreign Trade Policy to promote the 'Make in India' initiative.

Key policy proposals

Key announcements

- **Optical fibre roll out and digital village**

— The government has allocated an amount of INR10, 000 crore for Bharat Net project. The project currently covers about 155,000km

— By 2017-18, high speed broadband is likely to reach more than 150,000 gram panchayats with Wi-Fi hotspots at low tariffs

— Launch of the DigiGaon initiative to provide education, telemedicine and skills via digital technology.

- **Digital education**

— To promote digital education in the country, an online education platform Swayam would be launched with 350 education courses, accessible through Direct-To-Home (DTH) channels

- **Cybersecurity**

— A computer emergency response team (CERT) to be set up for close coordination with financial sector regulators and other stakeholders

- **Electronic manufacturing in India**

— An amount of INR745 crore has been allocated for modified special incentive package scheme (M-SIPS) and electronic development fund (EDF)

— To promote cashless transactions, the government has proposed to exempt BCD, Excise/CV and SAD on the domestic manufacturing of the device used for digital payments (miniaturised POS card reader for m-POS, micro ATM standards version 1.5.1, finger print readers/scanners and iris scanners).

- **Aadhaar pay**

— Announcement of Aadhaar-based smart cards containing health details for senior citizens

— Aadhaar-enabled merchant payment is to be launched soon, especially for those without net banking, e-wallets, and debit cards.

- **Digital transactions**
  - The government has set a target of 2,500 crore digital transactions for 2017-18 through debit cards, unified payment interface (UPI), Aadhaar pay, unstructured supplementary service data (USSD) andthis i immediate payment service (IMPS)
  - Banks have been given a target to introduce an additional 10 lakh point of sale (PoS) units by March 2017. In addition to that, they would be encouraged to introduce 20 lakh Aadhaar-based PoS by September 2017
  - The Budget encouraged petrol pumps, municipalities, block offices, universities, colleges and hospitals, to facilitate digital payments
  - A proposal to order all government receipts through digital means, beyond a prescribed limit, is being thought about carefully
  - The government would review and amend the Payment and Settlement Systems Act, 2007.
- **Bharat interface for money (BHIM) application**
  - The announcement of two new schemes to promote the use of the application are cashback scheme for merchants and referral bonus scheme.
- **The government has announced the following in the railway budget:**
  - Service tax has been abolished on online reservations done through Indian Railway Catering and Tourism Corporation (IRCTC) website
  - The announcement of metro rail policy is going to encourage indigenisation of both hardware and software through a thrust on digital economy
  - Clean my coach, a SMS-based service has been initiated in the Budget.

Direct tax proposals

- **Measures for stimulating growth**
  - Reduction in tax rate from 30 percent to 25 percent for companies with an annual turnover up to INR50 crore
  - Concessional 5 percent tax rate for interest payable to foreign companies on loans/bonds is extended till 2020
  - MAT credit allowed to be carried forward up to a period of 15 years instead of 10 years previously
  - Eligible start-ups can claim 100 percent tax holiday for any three consecutive years out of seven years from the year of incorporation
  - Change in shareholding in start-ups sheltered from denial of carry forward of business loss provided the existing shareholders to continue to hold the shares (with voting power) and such loss has been incurred during seven years from the year of the incorporation.
- **Promoting digital economy**
  - Deduction under section 80G for amounts exceeding INR2,000 to be allowed only if made otherwise than cash
  - Capital expenditure in cash beyond INR10,000 a day not to be eligible for tax depreciation
  - Threshold of cash payments to a person in a day reduced from INR20,000 to INR10,000
  - Cash receipts in excess of INR3 lakh per transaction/person in a day is subject to 100 percent penalty in the recipient's hands.
  - Presumptive taxation of eligible taxpayers reduced to 6 percent of non-cash revenues from FY16-17.

- **Ease of doing business**
  - Tax deduction at source on payments made to call centre operators reduced from 10 percent to 2 percent
  - Effective FY16-17, domestic transfer pricing to apply only if one of the domestic-related party with whom transaction is being considered is enjoying profit-linked deductions
  - Conversion of preference shares into equity made tax neutral
  - Foreign taxes paid after resolution of disputes to be allowed as credit under rectification proceedings in India
  - Indirect transfer provisions not applicable to Foreign Portfolio Investors Category I and II
  - Tax returns to be processed and refunds granted even in cases where assessment initiated
  - Revision of time limits:
    - Filing revised tax returns — reduced by one year
    - Regular assessment — 18 months for Assessment Year (AY) 2018-19 and 12 months for subsequent years
    - Reassessment/revisionary proceedings — 12 months from end of FY in which notice/order issued.

- **Anti-abuse measures**
  - Thin capitalisation provisions introduced, deduction of interest expenditure exceeding INR 1 crore capped at 30 percent of EBITDA; provisions made for carry forward of disallowed interest up to eight years
  - Secondary transfer pricing adjustments introduced for taxation of notional interest on non-repatriated primary adjustments exceeding INR1 crore
  - Capital gains exemption for transfer of equity shares acquired on or after 1 October 2004 available only if Securities Transaction Tax (STT) paid; the government is to notify the exceptions (notes accompanying the Finance Bill indicates that acquisition by way of IPO, rights issue, bonus, etc., may be included in the list of exceptions)
  - Deemed taxation on transfer of unquoted shares at less than the fair market value
  - Penalty (i.e., INR5, 000) leviable for delayed filing of returns replaced with a fee of up to INR10, 000.

- **Rationalisation measures**
  - Deduction under section 10AA to SEZ units to be allowed from 'total income' of the taxpayer, after setting-off of losses and unabsorbed depreciation
  - MAT provisions rationalised in line with Ind-AS; the framework for book profits computation is provided
  - Concessional 10 percent tax rate for LTCG on shares in private companies made applicable from 1 April 2013
  - Terms not defined in a Tax Treaty to be assigned meaning as per the Income Tax Act,1961, if defined therein
  - Powers of income-tax authorities to call for information and conduct surveys extended.

- **Employee taxation**
  - The rate of income-tax for the slab INR250,001 to INR500,000 to be brought down to 5 percent from 10 percent
  - A surcharge of 10 percent on tax proposed for individuals earning income exceeding INR0.5 crore and up to INR1 crore

— Partial withdrawal by an employee from the National Pension System proposed to be exempted from income-tax to the extent of 25 percent of the employee's contribution

— The cap on set-off of loss from house property at INR200, 000.

Indirect tax proposals

- **Goods and Services Tax**

  — Necessary steps taken by onboarding all stakeholders and the preparation of GST network is on schedule

- **Excise duty and custom duty**

  — Exemption from excise duty and BCD, CVD and SAD on miniaturised POS card reader for m-POS (not including mobile phones or tablet computers) micro ATM, fingerprint reader/scanner and iris scanner; parts and components for manufacture of the above are also exempt

  — SAD of 2 percent to be levied on import of Populated Printed Circuit Boards for use in the manufacture of mobile phones, subject to actual user condition.

- **R&D cess**

  — R&D cess abolished.

Impact

- The proposals contained in the Union budget 2017 are positive steps for the technology sector. One of the key themes of the budget was 'digital' and it was linked to several aspects of the budget. A strong focus on digitisation and bringing rural India to the forefront formed the key elements in the budget
- A strong emphasis was laid on the promoting the adoption of cashless methods for financial transactions, strengthening cyber security framework and improvising digital infrastructure. Creation of financial CERT will secure implementation of various e-initiatives. However, allocating more fund for cybersecurity could have enabled better regulation and adoption of advanced cyber technologies to support the digital economy
- India has grabbed the sixth position in manufacturing globally[12]. The increased allocation against M-SIPS and EDF can help India to become global hub for electronics
- Relaxation of conditions for providing income-tax incentives to start-ups could provide the much-needed impetus to the government initiatives for promoting domestic IT start-ups. The reduction in headline corporate tax rate for SMEs and carry forward of MAT credit for 15 years is a welcome step
- The government's emphasis to continue with the digitisation of tax processes, including e-assessments and the long-awaited introduction of GST, which is fundamentally built on digital and automation of processes, is likely to only lead to the increased contribution by the technology sector in building a transformed, energised and clean India.

[12] Union budget 2017-18 speech, accessed on 1 February 2017

Unfinished agenda

What remains?

- Robotics/cognitive technologies continue to grow as mainstream technologies. Incentives can be given to boost technology. Currently, no such incentive/benefits are given to stimulate the growth of these technologies in India
- A single-window mechanism for SMEs and start-ups for business-related compliances are yet to be introduced
- Equalisation levy remains at 6 per cent
- LTCG tax rate of 20 percent continues to apply w.r.t the sale of shares in start-ups
- Weighted R&D deduction not extended to software services
- Current salary ceiling of INR25,000 per employee not raised for 80JJAA deduction
- Safe harbour margins of 20–30 percent not lowered
- POEM and ICDS would continue to remain applicable from 1 April 2016
- The threshold for GAAR applicability of INR3 crores remains unchanged
- No clarity issued on e-commerce taxation w.r.t. service tax on aggregators, dual levy on software/delivery of goods.

What is expected going forward?

- The R&D is an investment without assurance of immediate success. With a rapidly changing technology landscape, R&D in the technology sector has become paramount. The government needs to provide incentives, rebates and tax benefits for domestic companies to build one of the leading works in India, to serve as a possible measure to counter economic protectionism elsewhere
- Rules/notifications to be issued for:
  - Mechanism for computing secondary transfer pricing adjustments
  - Transfers for which condition of STT chargeability on acquisition of equity shares would not apply
- There is an urgent need to commit to a GST go-live date, so as to enable the sector to take strategic decisions with respect to pricing, ERP redesigning, contracts modification, etc. The early finalisation of the GST law, rules and rates are equally important as the industry needs adequate time for a smooth transition and implementation.

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