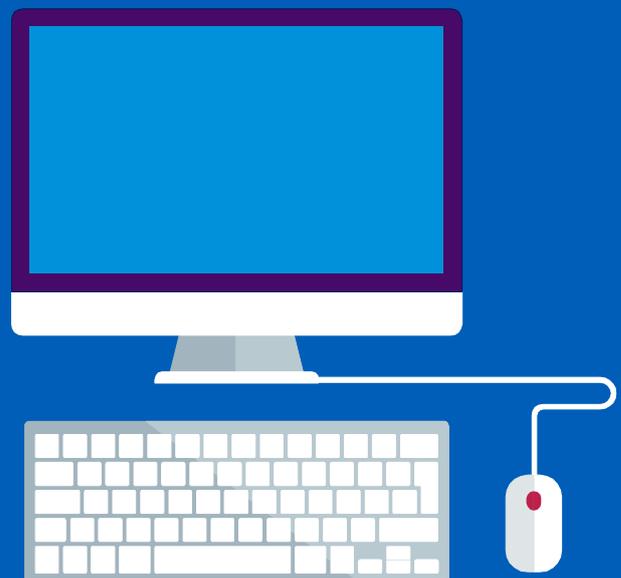




Technology

Union Budget 2016

Post-Budget sectoral point of view



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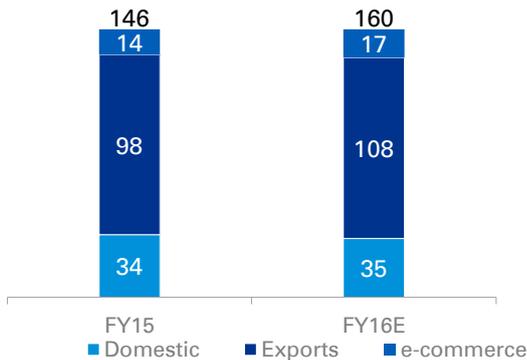
Context



Where we are¹

Indian IT-BPM industry

Revenue: Added ~USD14 billion over FY2015



Source: The IT-BPM Sector in India - Strategic Review 2016, NASSCOM.

Indian IT-BPM exports market

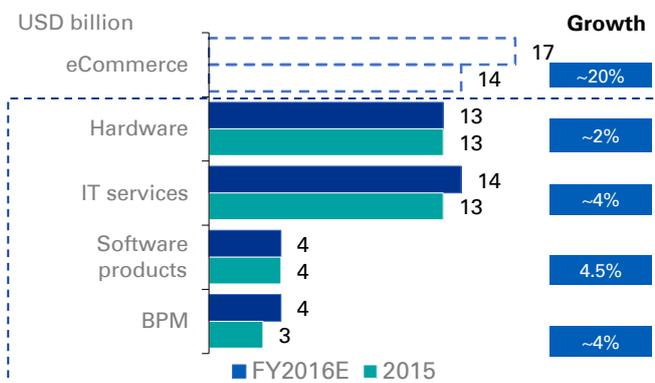
FY16E: 10.3 per cent y-o-y growth



Source: The IT-BPM Sector in India - Strategic Review 2016, NASSCOM.

Indian IT-BPM domestic market

Domestic market forms one-fourth share of Indian IT-BPM market



Source: The IT-BPM Sector in India - Strategic Review 2016, NASSCOM.

- India's Information Technology-Business Process Management (IT-BPM) industry is projected to grow at 8.5 per cent from USD132 billion in FY15 to USD143 billion in FY16 (excluding e-commerce). The growth in e-commerce is expected to be around 21 per cent. The industry's share in the total service exports is estimated at over 45 per cent. Overall, the industry workforce expects to reach 3.7 million by adding an additional 200,000 jobs
- The IT services segment has the maximum share of 52 per cent, followed by 20 per cent in BPM, 19 per cent in Engineering Services and Research and Development (ER&D) and packaged software and 10 per cent in hardware
- The Indian e-commerce market is estimated at USD16.7 billion in FY15

- Exports in FY16 are expected to be USD108 billion, with an annual growth of 10.3 per cent. The fastest growing segment is ER&D and product development grew at 12.6 per cent
- The emerging trends are Internet of Things (IoT) and disruptive innovation
- IT services are projected to grow by around 10 per cent
- BPM exports, with an approximate 9 per cent y-o-y growth, are being driven by Business Process-as-a-Service, mobility and advanced analytics
- The U.K. and the U.S. are the leading markets with a combined share of 80 per cent

- The domestic technology market is projected to grow at over 3 per cent to reach USD35 billion (excluding e-commerce) in FY16
- The drivers of technology adoption are large mobile-only population; ubiquitous connectivity and increasing data consumption; Social, Media, Analytics and Cloud (SMAC), etc.
- The fastest growing segments are expected to be software products and IT services
- BPM is being driven by Banking, Financial Services and Insurance (BFSI), telecom and e-commerce
- E-commerce is expected to achieve a 20 per cent y-o-y growth in FY16.

1. The IT-BPM Sector in India - Strategic Review 2016, NASSCOM.

Key issues/challenges



The IT hardware industry in India faces myriad of regulatory challenges that inhibit its growth. The government has started taking steps in the right direction under the 'Make in India' programme, but it still needs to significantly reduce regulatory and operational bottlenecks to spur the development of the IT manufacturing ecosystem. The IT services sector is facing pricing pressures on account of changes in IT spending patterns, focus on reducing long-term contracts, movement to smaller solution sales and lower demand from oil and gas (O&G) companies (on account of low crude prices). These issues are compounded by newer restrictions on work visa, increasing threshold of minimum salaries in the U.S. and proposed changes in the migration policy of the U.K.

Expectations (policy/fiscal/tax)



- A policy framework for Small and Medium Enterprises (SMEs), and technology start-ups to encourage budding entrepreneurs to develop and build innovative services to foster both the industry and economy's growth
- Need for greater clarity on the industry's contribution toward 'Digital India', 'Smart Cities' and 'Make in India' initiatives
- Promotion of Free/Libre and Open-Source Software (FLOSS) to advocate transparency and IT security among various e-governance and 'Digital India' initiatives
- Deferral of provisions around the draft of Place of Effective Management (POEM) guidelines
- Abolishment of the Minimum Alternate Tax (MAT) and Dividend Distribution Tax on Special Economic Zone (SEZ) developers/units, reduction of MAT rates, carry forward of MAT credit without time limits and lowering of the withholding tax rates on software
- Parity for Software Technology Parks of India/Export Oriented Units (STPI/EOU) units with SEZ units for exemption from payment of service tax on inputs, instead of the existing tedious refund claim process for STPI/EOU units
- Clarity on the classification of software either as 'goods' or 'services' to eliminate the dual levy of service tax and Value Added Tax (VAT), as an immediate remedial step.



Key policies/fiscal and tax proposals



Key announcements¹

Business

- Establishment of a technology-driven platform by the Director General of Supplies and Disposal to facilitate the procurement of goods and services by ministries
- Expansion of the scope of e-assessments to all taxpayers in seven mega cities to simplify compliance
- Expansion of the 'e-Sahyog' initiative to reduce compliance costs, especially aimed at small taxpayers
- For customs-bonded warehouses, there would be a proposal for change in the procedure to facilitate the shift from physical control to record-based control supported by sophisticated IT systems
- In a bid to foster the growth of the start-up landscape, the government aims to facilitate the registration of companies within a day
- Setting-up a unified agricultural marketing e-platform to give farmers access to markets
- Creation of e-Pashudhan Haat, an e-market portal for connecting breeders and farmers
- Launch of Digital Literacy Mission Scheme for rural India to facilitate digital literacy for 60 million households
- Revamp of National Land Record Modernisation Programme for building an integrated land information management system
- Introduction of computerised processing of court cases for the speedier resolution of stressed assets by the Debt Recovery Tribunal
- Establishment of a digital repository to help students and others to access educational certificates
- Provision of entrepreneurship education and training through Massive Open Online Courses (MOOC)
- Initiatives for minimum government and maximum governance through:
 - Development of a social security platform by using the Aadhaar framework for targeted delivery of financial and other subsidies, benefits and services
 - Provision of automation facilities in Fair Price Shops by March 2017
- The government has proposed the following in the Railway Budget:
 - Setting aside INR50 crore for providing innovation grants to start-ups
 - use of drones for remote monitoring of ongoing projects
 - cleaning of toilets upon receipt of a request through a Short Message Service (SMS), extending e-catering to all railway stations
 - inclusion of an e-ticket facility for foreign debit and credit card holders
 - introduction of bar-coded tickets on a pilot basis to tackle the menace of ticketless travel, enhancement of the capacity of e-ticketing system from 2,000 tickets/minute to 7,200/minute
 - Activation of Wi-Fi at 400 railway stations, introduction of the online recruitment process to bring about 100 per cent transparency, etc.



1. Union Budget 2016-17, <http://indiabudget.nic.in/glance.asp>, 29 February 2016

Direct tax proposals

Measures to boost growth and employment generation/phasing out incentives/deductions

- New manufacturing companies incorporated on or after 1 April 2016 to be given an option to be taxed at 25 per cent [plus surcharge and cess], subject to prescribed conditions
- 100 per cent deduction of business profits of eligible start-ups under section 80-IAC [incorporated between 1 April 2016 and before 1 April 2019] for three out of five years, subject to prescribed conditions
- Reduction in headline corporate tax rates for companies with a turnover of less than INR5 crore to 29 per cent [plus applicable surcharge and cess]
- Deduction under Section 80JJAA in connection with the employment of new workmen to apply to all taxpayers liable to tax audit, subject to prescribed conditions
- Insertion of new Section 115BBF to provide for income tax on gross basis at 10 per cent on income by way of royalties of a patent developed and registered in India. MAT provisions will not apply to such income
- Introduction of a sunset date of 31 March 2020 for the commencement of activity by SEZ units for claim of deduction under section 10AA
- Introduction of a sunset date of 31 March 2017 for the development of SEZ for claim of deduction under section 80-IAB by SEZ developers
- Phasing out Research and Development (R&D) benefits under section 35(2AB) to 150 per cent [instead of the existing 200 per cent] with effect from 1 April 2017 and to 100 per cent with effect from 1 April 2020.

Provisions reflecting Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) recommendations

- Country-by-country (CbyC) reporting introduced as part of Transfer Pricing (TP) compliances by companies with a consolidated revenue of more than EUR750 million
- Equalisation levy of 6 per cent of consideration payable to non-residents towards online advertisement or other specified services; underlying income subject to tax exemption.

Reducing litigation and providing certainty in taxation

- Non-applicability of MAT with effect from 1 April 2000 to foreign companies not having a Permanent Establishment (PE) in India
- Non-residents not having a PAN will not be subjected to a higher rate of withholding under section 206AA upon furnishing of alternative documents, as may be prescribed
- No appeal to be filed by the tax department against the directions of the Dispute Resolution Panel
- Limited period compliance window for domestic taxpayers introduced; 45 per cent of undisclosed income payable as tax, surcharge and penalty
- New Dispute Resolution Scheme introduced; settlement provisions laid out for payment of disputed tax/interest/penalty, subject to certain conditions
- With respect to retrospective amendment on indirect transfer of shares, a one-time scheme of dispute resolution for ongoing litigation cases has been introduced
- New penalty framework incorporated which provides for graded penalty for under-reporting of income/misreporting of facts.

Other proposals

- Long-term capital gains arising to non-residents from the transfer of shares of a closely held private limited company to be taxed at 10 per cent
- Place of Effective Management (POEM) provisions deferred by one year; to be effective from 1 April 2016
- GAAR to be effective from 1 April 2017
- Time limits for completion of assessment/reassessment reduced by three months in all cases.

Employee taxation

- Employer contribution to Recognised Provident Fund in excess of INR150,000 per annum now taxable
- Tax exemption on withdrawal of provident fund now limited to 40 per cent of the accumulated balance, attributable to contributions made on or after 1 April 2016 by an employee. Salary limits to be separately prescribed for employees excluded from tax on such withdrawals.

Indirect tax proposals

Service tax

- Service tax rate retained at 14.5 per cent [including 'Swachh Bharat' cess of 0.5 per cent]; with effect from 1 June 2016. The effective rate works out to 15 per cent, after including 'Krishi Kalyan' cess of 0.5 per cent on the taxable value
- With effect from 1 March 2016, service tax on the services of IT software on media bearing Retail Sale Price (RSP) as per Legal Metrology Act, 2009, is being exempted, provided the central excise duty is paid on RSP in accordance with Section 4A of the Central Excise Act.
- With effect from 1 March 2016, in case of customised software, which is not subject to RSP:
 - Only service tax would apply
 - The same would not be liable to central excise duty/countervailing duty (CVD). However, the central excise duty/CVD is required to be paid on the value of the medium on which the IT software is recorded.

Central excise/customs

- Peak excise duty/custom duty rate retained at 12.5 per cent and 10 per cent, respectively
- The number of central excise returns to be filed has been reduced from 27 to 13. Further, a facility for revision of excise return is introduced for manufacturers
- Central excise/customs duty exemption extended/withdrawn on specific IT hardware/products.

Cenvat Credit Rules, 2004

- Clarity brought about regarding the time limit of claiming a refund of service tax under Rule 5 of the Cenvat Credit Rules as under:
 - Receipt of payment in convertible foreign exchange, where provision of service has been completed prior to the receipt of such payment
 - The date of issue of invoice, where the payment for the service has been received in advance, prior to the date of the issue of the invoice
- Export of services excluded from the definition of exempted services.

Others

- Interest rates on delayed payment of duty/service tax across all indirect taxes are proposed to be made uniform at 15 per cent, except in case of service tax collected but not deposited into the exchequer, in which case the rate of interest will be 24 per cent from the date on which the service tax payment was due
- Introduction of the Indirect Tax Dispute Resolution Scheme, 2016, with respect to cases pending before the Commissioner (Appeals). The cases can be closed after paying the duty, interest and penalty equivalent to 25 per cent of the duty
- Annual service tax and central excise return is introduced and needs to be filed on or before 30 November for each financial year. These annual returns can be revised before 31 December
- The period of limitation for recovery of service tax/excise duty/customs duty has been enhanced.



Our point of view

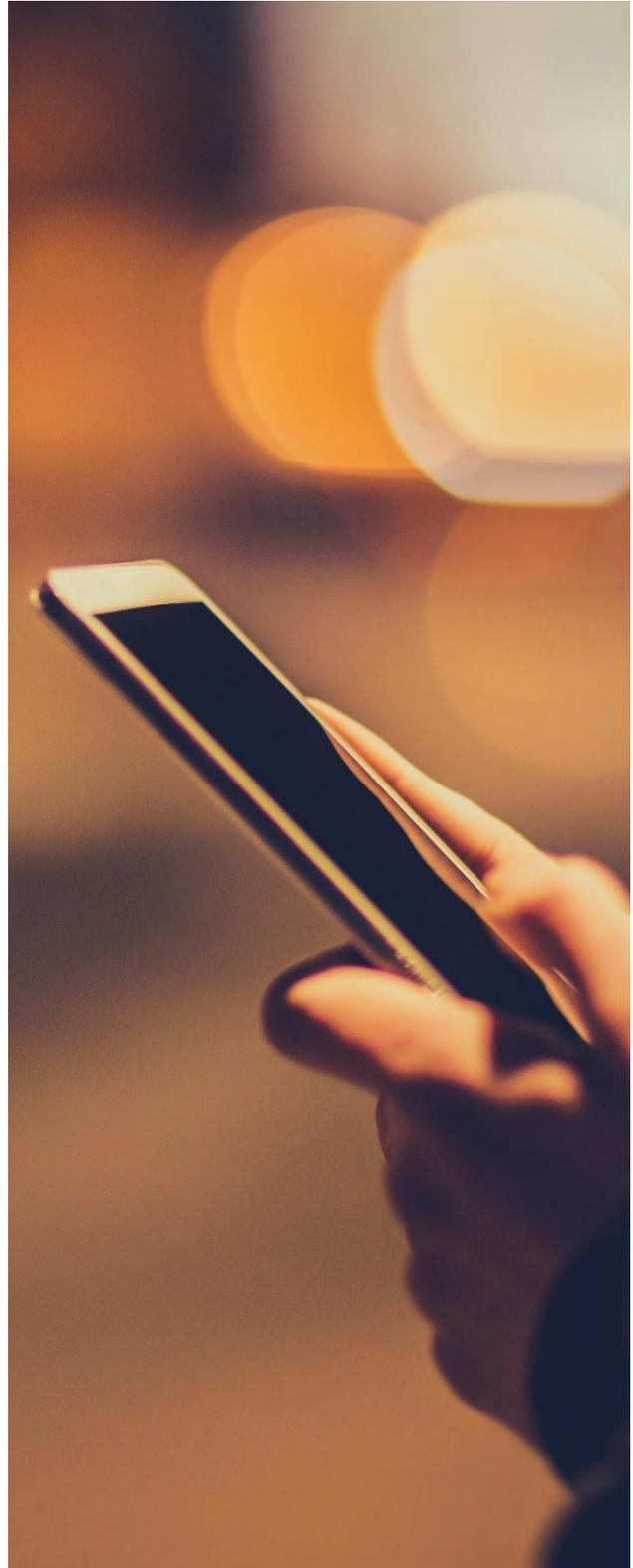


The proposals contained in the Union Budget 2016 are positive steps for the technology sector. A strong emphasis is laid on driving efficiency and effectiveness across the nine pillars mentioned in the Budget with the use of technology. Various employment generation/tax incentives have been proposed to augment the 'Make in India' and 'Start-up India' initiatives.

In line with the expectation of a reduction in corporate tax rates in the coming years, phasing out profit-linked incentives/deductions by providing sunset clauses has been introduced as a pre-requisite. Accordingly, SEZ units/developers that commence activity up to 31 March 2020/31 March 2017, respectively, would be eligible for an income tax holiday.

Deferral of POEM by one year can bring temporary relief particularly to technology companies that have outbound investments. The Introduction of special patent regime provides for a concessional taxation regime (10 per cent on gross income and non-applicability of MAT provisions) for income from exploitation of patents developed and registered in India, and would help retain and commercialise existing Intellectual Properties (IPs) and develop new innovative patented products in India. This however needs to be supported by effective IP laws in India. A proposal to continue the weighted deduction on R&D spend in a phased manner up to 31 March 2020 can provide the much needed impetus to the sector's R&D activities.

With an aim to provide ease of doing business, significant steps have been taken to reduce the number of compliances, bringing in clarity with respect to the date of exports and reducing litigation, which is a welcome proposition.



Unfinished agenda

What remains



Regulatory

- With the announcement of 98 Smart Cities¹ in the country, the technology industry awaits greater clarity on its contribution, governance and policy framework
- The manufacturing sector, including producers of IT hardware components, has faced a lot of challenges in the last few years, stimulating the need for reforming the excise duty structure and working around the prevalent sales tax rates and logistic costs.

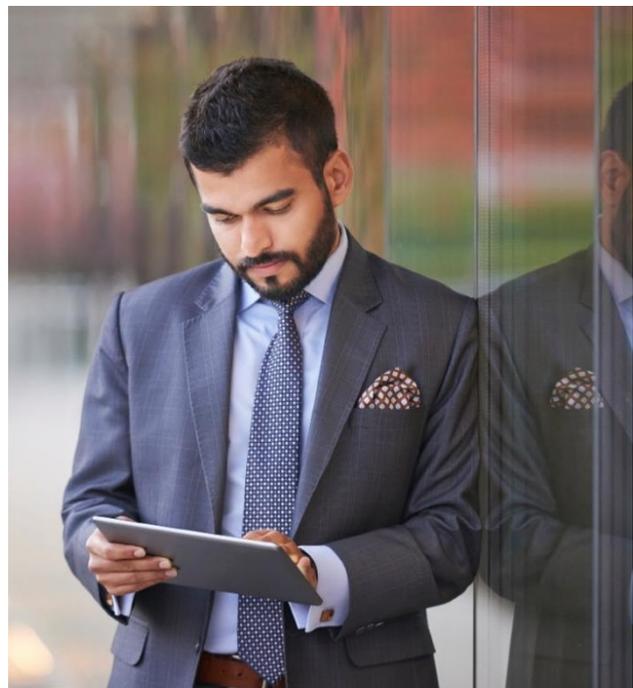
Tax

- Levy of Dividend Distribution Tax (DDT) and MAT on SEZ units/developers continues to remain applicable
- Tax withholding on software payments continues to remain at 10 per cent under Section 194J
- No rules prescribed for the claim of foreign tax credit by Indian companies
- Tax holiday of only three out of five years for start-ups does not appear to be sufficient considering that start-ups could make losses in their initial years. Also, the levy of MAT on start-ups takes away the benefit of the deduction to a great extent
- Tax holiday for start-ups has not been extended to existing companies, which would have been a welcome move. Also, the deductions meant for start-ups is available only to 'companies' and not to firms/Limited Liability Partnerships (LLPs)/individuals
- No exemptions provided to start-ups on considerations received from domestic investors over fair market value
- Dual levies on software products remain addressed
- Place of Provision of Service Rules have not been clarified.

What is expected going forward



- There is a need to establish processes for the protection of IP rights in the pursuit of attracting foreign investment and establishing high quality standards in domestic manufacturing
- There is a need to increase the focus on cybersecurity, which ensures compliance across the ecosystem and yields long-term benefits
- Rules/final guidelines/procedures still need to be framed for:
 - Direct tax dispute resolution
 - Opting for the 25 per cent tax rate by manufacturing companies
 - POEM
 - General Anti Avoidance Rules
 - CbyC reporting
 - Income disclosure schemes
 - Digital services liable to equalisation levy
 - Foreign tax credit
 - Buy-back tax, etc.



1. 'Centre unveils list of 98 smart cities' The Hindu, 28 August 2015.



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