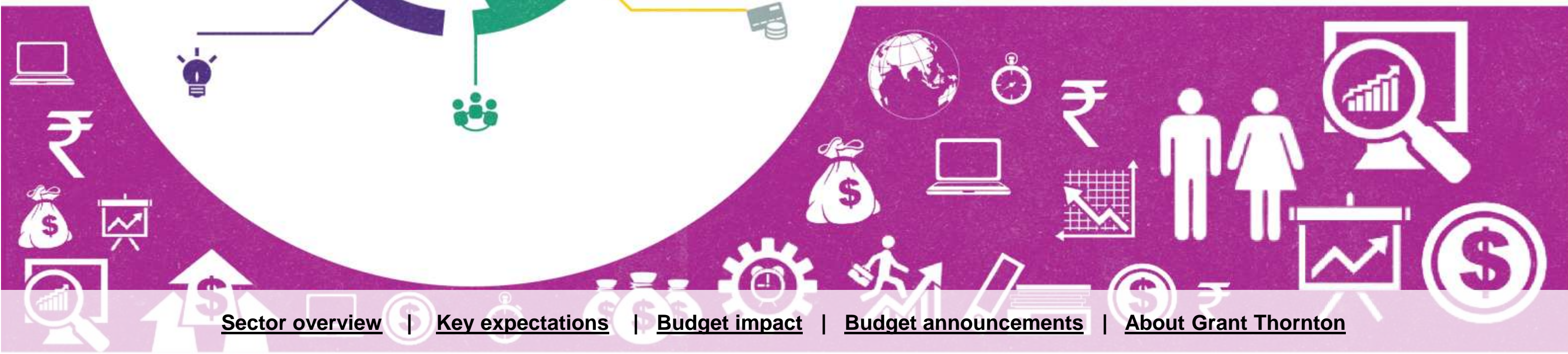


# Union Budget 2015-16

## Impact on the Technology sector



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# Sector overview

## Sector overview

Software development and information technology enabled services (ITeS) including business process management (BPM), software engineering R & D services and product development has emerged as one of the most dynamic and vibrant sectors in India's economy. The credentials of this sector are as follows:

- ITeS sector is the single largest contributor to services exports
- Technology sector is one of the largest employers in the country, directly employing nearly 3.5 million people

As per the Central Statistics Office (CSO), computer and related services had a share of 3.3% in India's GDP and grew by 14.4% in 2013-14. As per NASSCOM's estimate the revenue of the IT-BPM industry stood at US\$ 119 billion and grew by 12% in 2014-15, while the export market stood at US\$ 98 billion and grew by 12.3% over the previous year.

As per AT Kearney's Global Services Location Index 2014, India ranks first and remains the pre-eminent destination for offshore services, with excellence in IT, BPO, and voice services. Further, India also ranks as the fourth largest start-up hub in the world with over 3,100 start-ups in the country.

## Growth drivers

India's emergence as one of the fastest growing technology consultancy markets worldwide is largely attributable to the following:

- Increased investment activities
- Liberalisation of FDI
- Entry of many new players into the Indian market
- Low cost sourcing
- Advent of advanced delivery platforms
- Knowledge based transformation
- Improved access to services through IT-enabled platforms
- Greater transparency in government processes
- Increased indigenous production of IT hardware and software
- Increased adoption of technology in rural areas

# Sector overview

## Challenges

Roadblocks that could derail the growth momentum of the technology sector include:

- High labour attrition and increasing wages
- Shortage of talent
- Lack of data protection laws in the country
- Slow recovery of the global economy
- Infrastructure bottlenecks

## Regulatory initiatives

- Launch of e-biz portal which integrates 14 regulatory permissions at one source



# Key expectations

## Industry expectations

- Incentives to promote growth and generate employment in tier II and tier III cities
- Liberal measures to raise global capital for technology driven companies
- Measures to monitor predatory pricing and criminal frauds
- Better regulations to handle server registration and data protection
- Indirect tax reliefs to IT hardware manufacturing industry
- Tax incentives to software players setting up units in non-SEZ locations
- Easier policy and tax regime to assist start-up technology companies
- Clarifications around tax implications on cloud computing
- Simplification of tax and regulatory laws for e-commerce players and e-tailers
- Availability of input tax credit for Rent-a-Cab Services
- Definition of capital goods to include all kinds of motor vehicles and Cenvat credit of the same should be eligible
- Time Limit of 6 months for availing Cenvat credit should be withdrawn



## Budget impact – Our view

The Budget recognises the entrepreneurial spirit in the technology sector and proposes investments for start-ups and reduction of tax rates for technical services/royalty fee, which is a welcome step. However, we believe that the proposed investment of Rs 1,000 crore is a good start but clearly very small compared to the capital needs of the start-ups.

Also, the deferral of GAAR would possibly accelerate the deal making activities in technology sector, especially inbound deals and PE buy-out deals.

# Budget announcements - Key policy initiatives

## Make in India vision

- Technology sector has now been dubbed as India's sunrise sector and the government lays more focus on technology and e-commerce industry
- Recognising the importance of IT, the government's Make in India mission has included IT and BPM among the 25 focus sectors
- Self-Employment and Talent Utilisation (SETU) to be established as techno-financial, incubation and facilitation programme to support all aspects of start-up business

## Digital India vision

The National Optical Fibre Network Programme (NOFNP) of 7.5 lakh kilometres networking 2.5 lakh villages is being further promoted by allowing willing states to undertake its execution on reimbursement of cost, as determined by Department of Telecom



# Budget announcements - Direct tax proposals

## Royalties and fees for technical services

Tax rate on royalty and fee for technical service payable to non residents has been reduced from 25% to 10%. This would be a major boost for import of new technology and services into India.

## Residential status for companies

A company shall be considered resident if it has place of effective management in India any time during the year. The term place of effective management (POEM) has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. This would have major impact on the outbound investments made by the technology companies as overseas subsidiaries may be considered to be effectively managed from India, consequently deemed to be resident in India and taxed accordingly.

## Domestic transfer pricing

The threshold for applicability of domestic transfer pricing provision has been increased from Rs 5 crore to Rs 20 crore. This would be beneficial for start up and mid size technology companies as they would be excluded from unnecessary compliance requirements.



# Budget announcements - Direct tax proposals

## Income tax rates - Companies:

- Surcharge for Domestic companies increased by 2% as under:
  - surcharge @ 7% (if the taxable income > Rs 1 crore but < Rs 10 crore )
  - surcharge @ 12% ( if the taxable income > Rs 10 crore )
- Surcharge for foreign companies remain unchanged
- The Finance Minister proposes to phase out exemptions and bring corresponding reduction in corporate tax rate from 30% to 25% over the next four years

## Procedural simplification

- Wealth tax to be abolished
- Direct Tax Code shelved as most provisions have been included in the extant Income-tax Act

The proposal to reduce corporate tax along with phasing out of exemptions is a welcome step towards improving the ease of doing business. However, no roadmap in this regard has been laid out.



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# Budget announcements - Direct tax proposals

## ➤ Clarification on 'Indirect' transfers

The meaning of the term “substantially” with respect to transactions involving indirect transfer of assets in India has been clarified as follows:

- The value of assets (whether tangible or intangible) situated in India exceed Rs 10 crore **and** comprises at least 50% of the value of total assets (without reduction of any liabilities) of the foreign company as on the valuation date
- Valuation date shall be the last day of the accounting period preceding the date of transfer. However, where the book value of assets on the date of transfer exceeds book value as on the last day of the accounting period by 15%, valuation should be done on the date of transfer
- The manner of determination of fair market value of the Indian assets vis-à-vis global assets shall be prescribed in the rules
- The taxation of gains arising on transfer of a share or interest deriving directly or indirectly its value substantially from assets located in India will be on proportional basis (computation mechanism to be prescribed)
- Indian entity to comply with prescribed reporting requirements in relation to indirect transfer, and failure to do so shall attract penalty
- The following transactions have been excluded from the ambit of indirect transfers:
  - **Transfer of direct holding company:** Non resident transferor does not hold right of management, control, voting power or share capital exceeding 5%, at any time immediately preceding the 12 month period, in the direct holding company i.e. company directly holding shares in the Indian company



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# Budget announcements - Direct tax proposals

## Clarification on 'Indirect' transfers

- **Transfer of indirect holding company:** Non resident transferor does not hold right of management, control in such company, nor does he holds any right in such other company which would entitle him to right of management, control, voting power or share capital exceeding 5% in direct holding company
- **Amalgamation / demerger:** Transfer of shares of a foreign company deriving substantial value from shares of Indian company, in a scheme of amalgamation or demerger between two foreign companies, subject to prescribed conditions. Consequently, the cost of acquisition and the period of holding will be computed with reference to the original investment

## General Anti Avoidance Rule (GAAR)

- Applicability of GAAR has been deferred to 1 April 2017 Further, all investments made till 31 March 2017 have been grandfathered and would be out of ambit of GAAR provisions

Clarification on 'Indirect' transfer is a welcome move. Specially provisions relating to exclusion for small holdings and group restructuring through amalgamation and demerger would provide the much needed relief. However, it would have been helpful if all group restructurings were exempted rather than only mergers and demergers.



# Budget announcements - Direct tax proposals

## Global Depository Receipts (GDR)

Definition of GDR has been amended to mean any depository receipt or certificate created by the Overseas Depository Bank outside India and issued to investors (resident as well as non-residents) against the issue of:

- ordinary shares of a company listed on a recognised stock exchange in India; or
- foreign currency convertible bonds of issuing company

Thus, other GDRs under the widened definition of SEBI regulations will not be able to avail tax benefits, which is envisaged for sponsored GDRs and listed companies.

## Minimum Alternative Tax (MAT) on FIIs to be rationalised

In recent past there has been a debate on levy of MAT on income of FII / FPIs. While FPIs were arguing that they are not subject to MAT, the revenue authorities were wanting to collect MAT on their income.

MAT provisions are proposed to be amended to provide for exclusion of income of FPIs. However, short term capital gains, which are not subject to STT, would be subject to MAT.

**MAT exemption to FPIs has been provided with prospective effect. It should have been a clarificatory amendment to mitigate past disputes as well!**



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# Budget announcements - Indirect tax proposals



## Customs - With effect from 1 March 2015

- Exemption of Special Additional Duty (SAD) on all inputs (except populated PCBs) for use in the manufacture of specific ITA bound goods.
- Exemption of basic customs duty (BCD) and countervailing duty (CVD) on parts and accessories and their sub-parts used in the manufacture of tablet computer
- Exemption of BCD on digital still image video cameras capable of recording video with minimum resolution of 800x600 pixels, at minimum 23 frames per second for at least 30 minutes in a single sequence using the maximum storage capacity and their parts and accessories.
- Exemption of BCD on organic LED TV panels.
- Exemption of SAD on all inputs in the manufacture of LED driver and MCPCB for LED lights and fixtures & LED Lamps.



## Excise - With effect from 1 March 2015

- Excise duty rate of 2% without CENVAT credit or 12.5% with CENVAT on tablet computer
- Exemption of excise duty on parts, components and accessories and their sub-parts for use in the manufacture of tablet computer
- Reduction in excise duty from 12% to 6% on all inputs for use in manufacture of LED driver and MCPCB for LED lights and fixtures & LED lights
- Retail sale price based assessment for LED lights or fixtures including LED lamps with an abatement of 35%.



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# Budget announcements - Indirect tax proposals

## Customs - With effect from 1 March 2015

- The general effective customs duty rate has been increased from 28.85% to 29.44%

**Effective from date of enactment of Finance Bill, 2015; unless otherwise specified**

- Penalty provisions rationalised in favor of taxpayer
- Prosecution provisions of Section 132 of the Customs Act, 1962 relating to giving false declarations, false documents etc. incorporated as an offence in Part B of the Money Laundering Act

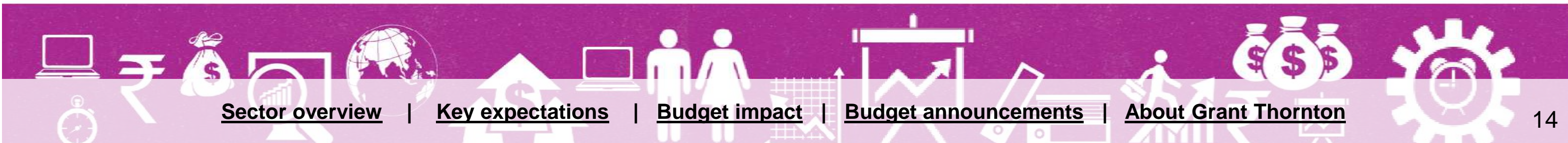
## Service tax - Effective from a date to be notified after enactment of Finance Bill, 2015

- Service tax rate increased from 12.36% (inclusive of all cess) to 14% (subsuming all cess).
- Additional 2% proposed to be charged on taxable service value in the form of Swachh Bharat Cess (SBC).

**Effective from 1 April 2015, unless otherwise specified**

- The rate of abatement available in relation to GTA services ,transport of good by vessel and transport of passengers by air is as follows:

Particulars	Pre Budget	Post Budget
Transport of goods by road	75%	70%
Transport of goods in a vessel	60%	70%
Transport of passenger by air		
- Economy class	60%	60%
- Other than economy class	60%	40%



# Budget announcements - Indirect tax proposals



## Service Tax... continue - Effective from 1 March 2015, unless otherwise specified

- Digitally signed invoice, bills, challans or consignment notes given legal status
- Service tax records may be maintained in electronic form with digital signature on each page.
- Class of persons eligible to approach the advance ruling authority now includes specified resident partnership firms as defined under the service tax law.
- Definition of 'consideration' expanded to include reimbursements charged in course of providing taxable service
- Where service tax disclosed as payable in returns but amounts not paid, coercive measures of recovery could be initiated without issuing demand notice
- Specific provisions introduced to facilitate smooth transition of pending matters from previous penalty regime to above proposed penalty regime

- Penalty provisions rationalised in favour of taxpayer in the following manner:

Event	Amendment
Notice to recover service tax not paid/ short paid (a) in cases not involving fraud, etc  (b) in cases involving fraud, etc	If disputed service tax paid within 30 days from receipt of notice (a) No penalty to be charged (If disputed service tax paid after 30 days in cases not involving fraud, penalty reduced from 50% to 10%) (b) penalty reduced from 100% to 15% in cases where fraud involved
Order passed for recovery of service tax	If service tax paid within 30 days of the Order, penalty reduced to 25% of amount demanded in said Order



# Budget announcements - Indirect tax proposals



## CENVAT Credit Rules, 2004 - Effective from 1 March 2015; unless otherwise specified

- The period of availing CENVAT credit on inputs and input services extended from six months to one year from date of invoice / challan or other specified documents
- CENVAT credit of service tax paid under domestic reverse charge now allowed to claimant, without linking it to the payment of services to the input service provider (effective from 1 April 2015)
- Effective from 1 April 2015, CENVAT credit wrongly taken (i.e. availed) or utilised by manufacturer or output service provider to attract recovery proceedings under Central Excise Act and service tax law respectively with similar penalties
- CENVAT credit on inputs and capital goods allowed to manufacturer or output service provider, as the case may be, even in case of direct receipt of such goods in the premises of the job worker on the direction of principal manufacturer / output service provider
- CENVAT credit allowed to principal manufacturer on inputs, whether as such or after partial processing, sent from premises of one job worker to another job worker. The time limit for return of capital goods from premises of a job worker to principal manufacturer/ output service provider increased from six months to two years



## GST

- Central government working closely with the Empowered Committee of State Finance Ministers (Empowered Committee) to ensure that the implementation of GST in India meets the self-imposed timeline of 1 April 2016
- To enable GST introduction, Constitution Amendment Bill tabled in the winter session of Lok Sabha (Lower House of Parliament). It is expected that the ground level consensus built through the Empowered Committee would create political consensus to move the Bill through both Houses of the Parliament shortly
- The Finance Minister reiterated that GST introduction is equal to introducing "state-of-the-art" indirect tax system in India, through the joint efforts of the Centre and the states
- However, there was no discussion on rates or roadmap and much work needs to be done
- **Given the above limitations, introduction of GST by 1 April 2016 still seems optimistic**



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# About Grant Thornton

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