Union Budget 2018

Impact on IT & ITeS Sector

February 2018

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Contents

DIGITAL ECONOMY

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Continued reliance on Technology

- Allocation of digital India doubled to INR 3073 crore.
- Disposal of its business by introduction of e-office and other e-governance initiatives in Central Ministries and Departments
- A web-based Government Integrated Financial Management Information System (GIFMIS), administered by Controller General of Accounts, for budgeting, accounting, expenditure and cash management for more effective fiscal management of Government.
- Project ‘e-Vidhan’ to digitize and make the functioning of all State Legislatures paperless.
- E-Courts, to bring about universal computerization of all Districts and Subordinate Courts, use of cloud computing and availability of e-services like e-filing and e-payments as well.
- Increasing use of technology for safety under railways ‘‘Fog Safe’’ and ‘‘Train Protection and Warning System’’
- Transforming education sector – by increasing use of digital intensity in education – black board to digital-board - upgrade the skills of teachers

STARTUPS – KEY POLICY ANNOUCEMENTS

Start-ups - Key policy announcements

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- A separate policy to be evolved for issuance of hybrid instruments for attracting foreign investments especially for the start-ups and venture capital firms
- Specific tax proposals discussed later

DIRECT TAX PROPOSALS

Corporate tax rate card

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Types of companies	Income up to INR 1 crore		Above INR 1 crore up to INR 10 crore		Above INR 10 crore	
	Surcharge rate	Effective tax rate	Surcharge rate	Effective tax rate	Surcharge rate	Effective tax rate
Indian company, with turnover not exceeding INR 250 crores in FY 2016-17	Nil (Nil)	26.00% (30.90%)	7% (7%)	27.82% (33.06%)	12% (12%)	29.12% (34.61%)
New domestic manufacturing (set up and registered on or after 1 March 2016)*	Nil (Nil)	26.00% (25.75%)	7% (7%)	27.82% (27.55%)	12% (12%)	29.12% (28.84%)
Other Indian companies	Nil (Nil)	31.20% (30.90%)	7% (7%)	33.38% (33.06%)	12% (12%)	34.94% (34.61%)
Foreign	Nil (Nil)	41.60% (41.20%)	2% (2%)	42.43% (42.02%)	5% (5%)	43.68% (43.26%)

**Compliant with prescribed conditions under section 115BA*

Note:

- *Health and Education Cess of 4% has been considered for determining the tax rates above*
- *Figures in bracket represent existing tax rates*

Minimum Alternate tax rate card

Types of companies	Income up to INR 10 million		Above INR 10 million up to INR 100 million		Above INR 100 million	
	Surcharge rate	Effective tax rate	Surcharge rate	Effective tax rate	Surcharge rate	Effective tax rate
Domestic	Nil (Nil)	19.24% (19.06%)	7% (7%)	20.59% (20.39%)	12% (12%)	21.55% (21.34%)
Foreign	Nil (Nil)	19.24% (19.06%)	2% (2%)	19.62% (19.44%)	5% (5%)	20.20% (20.01%)

Note:

- *Health and Education Cess of 4% has been considered for determining the tax rates above*
- *Figures in bracket represent existing tax rates*

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Direct Tax announcements

Announcements on Start-ups

- Extending tax holiday eligibility to start-ups incorporated up to April 1, 2021 (extended from April 1, 2019)
- Eligible businesses criteria to now include businesses with high potential of employment generation and wealth creation (aligned with definition provided by the DIPP, Ministry of Commerce in May 2017)

Direct Tax announcements

Extension of incentive under section 80JJAA

- Rationalisation of the incentive for new employees who would not satisfy the requirement of having been employed for at least 240 days in the first year of hiring – such employee will now be deemed to be a 'new employee' of the immediately succeeding year and all other rules will apply accordingly
- Illustration (threshold – 240 days employment)

FY	Scenario 1	Scenario 2	Scenario 3	Scenario 4
2017-18	130 days			
2018-19	More than 240 days	130 days	90 days	240 days
2019-20	More than 240 days	110 days	More than 240 days	More than 240 days
2020-21	More than 240 days	Resigned	More than 240 days	More than 240 days
FY in which deduction under Section 80JJAA can be claimed	Not available, as changed law applies from FY 2018-19 only	None	FY 2019-20 to FY 2021-22 (30% in each year)	FY 2018-19 to FY 2020-21 (30% in each year)

Direct Tax announcements

Taxation of long term capital gain

- Long term capital gains tax exemption on transaction of sale of listed equity shares/units of equity oriented fund/units of business trust undertaken on stock exchange and subject to STT is withdrawn
- Now taxable at 10% of capital gains exceeding INR 100,000 (per annum and not per transaction) without indexation benefit
- Capital gains upto January 31, 2018 proposed to be grandfathered by stepping-up the ‘cost of acquisition’ to fair value as of Jan 31, 2018
- No change in period of holding to qualify for long term
- Foreign Portfolio Investors also to be taxed on long term capital gains at 10%

Long term capital gains tax rate of equity shares

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Nature of shares	Rate of Tax (%)	
	Resident investor	Non-resident investor
Unlisted shares	20%	10%
Listed shares (sold off the market)	10% / 20%*	10%
Listed shares (STT paid# on sale and purchase)	10% (exceeding INR one lakh)	10% (exceeding INR one lakh)

**After applying indexation*
#Central Government empowered to notify acquisitions in respect of which STT shall not apply

Direct tax announcements

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Income Computation and Disclosure Standards (ICDS)

- Pursuant to the Delhi HC ruling (*Chamber of Tax Consultants)* that struck down key provisions of ICDS, ICDS rules have been now brought into the IT Act
- Income/loss from service contracts to be based on Percentage of Completion Method (no flexibility for choosing other methods of revenue recognition, as compared to AS/Ind AS); exceptions – (i) straight line method for certain contracts (ii) project completion method for short term projects (<90 days)
- Disallowance of mark-to-Market (MTM) losses/notional losses (not allowed under ICDS) gets legal sanction now by way of amendment to the IT Act
- ICDS amendments shall retrospectively apply from FY 2016-17 (first year when ICDS was made applicable)

Measures to widen tax base - Dividend

Dividend Distribution Tax on deemed dividend at 30% (without grossing up)

- Applicable on loans / advances to shareholder / entity in which shareholder owns substantial interest etc
- Earlier, such deemed dividend taxable in the hands of recipient at applicable rates and not subject to DDT

Dividend Distribution tax on dividend payout by equity oriented mutual fund at the rate of 10%

Widening the meaning of accumulated profits (specific anti-abuse amendment)

- Accumulated profits / losses shall be increased by the accumulated profits (whether capitalized or not) of the amalgamating company on the date of amalgamation

Effective rate of DDT increased to 20.56% on account of change in additional surcharge (i.e. Health and Education Cess). However, DDT introduced on deemed dividend under Section 2(22)(e) resulting in effective tax rate of 34.94%

Direct Tax announcements

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Taxing Digital Economy- Non residents

- Definition of business connection widened to align with BEPS Action Plan 7 and MLI. Also concurs with Indian Revenue's reservation to the OECD commentary on Agency PE
- 'Business Connection' (BC) definition widened - 'Significant Economic Presence' (SEP) of a non-resident in India to constitute BC in India irrespective of non-resident not having a physical presence, residence or place of business in India
- SEP to mean:
  a) transaction in respect of goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transactions during the previous year exceeds prescribed threshold; or
  b) systematic and continuous soliciting of business activities or engaging in interaction with prescribed number of users in India through digital means

- ***Could have significant tax impact for overseas players in the digital business space - will not currently impact non-residents relying on DTAA***
- ***Interplay/overlap with Equalization Levy (EL) to be seen; EL currently applies only to online ad payments and in cases where non-resident does not have a permanent establishment in India***
- ***BEPS Action Plan 1 identified 'significant economic nexus test' and 'equalization levy' as alternative measures that countries may adopt***

Other rationalization measures

Rationalization of capital gains provisions

- Transfer of capital assets between a holding company and its wholly owned subsidiary has been proposed to be excluded from the scope of 'Income from Other sources' [tax u/s 56(2)(x)]
- Scope of section 54EC restricted:
  - Applicable only to capital gains arising from long-term capital assets, being land or building or both
  - Long-term specified asset, for making any investment under section 54EC on or after the 1st day of April, 2018, shall mean any bond, redeemable after five years and issued on or after 1st day of April, 2018 by NHAI or by RECL or any other bond notified

Other announcements

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Others

- Compensation (revenue of capital) for termination or modification of a contract relating to business to be taxable as business income and relating to employment to be taxable as income from other sources *(may apply to termination/amendment of marketing/distribution agreements)*
- New scheme for scrutiny assessments(e-assessments) to be introduced by way of notification
- Obtaining Permanent Account Number (PAN) mandatory for companies/ other body corporates (all non-individual assessees) entering into financial transactions of amount aggregating to INR 250,000 or more in a financial year
- Deduction under any of the provisions mentioned under the heading "C-Deduction in respect of certain incomes" in Chapter VI-A shall not be allowed unless the return of income is filed by the due date - Deduction under section 80H to 80RRB proposed to be covered under the aforesaid amendment

Key Personal tax proposals

Tax Rates

- No change in income slabs or tax rates or surcharge
- Education cess of 3% substituted with Health and Education cess of 4%

Standard Deduction

- Standard Deduction of INR 40,000 or amount of salary received whichever is less has been introduced. Exemptions currently available for Transport Allowance amounting to INR 19,200 per annum and reimbursement of medical expenses amounting to INR 15,000 per annum is proposed to be withdrawn. Effective incremental benefit is Rs 5,800 (40,000 (-) 34,200). Transport allowance exemption for differently abled person to continue.

Key issues unaddressed

- R&D Benefits for the IT sector – Section 35(2AB)
- Removal of angel taxation for all start-ups
- Exemption from MAT on start-ups which claim the tax holiday
- Lowering TDS rate for all software payments
- Maintain 60% rate for depreciation on computer & computer software
- Comprehensive review of foreign tax credit rules
- Provide credit on equalisation levy
- No clarifications on Secondment arrangements
- POEM relaxations - *separate discussions are ongoing with the Government*

TRANSFER PRICING PROPOSALS

Transfer pricing – Clarifications to existing CbCR provisions

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- Cases where an Indian resident entity has to file CbCR in India:
  - If the prescribed threshold of consolidated revenue of the Multinational Group (i.e. INR 5500 crores) is crossed; ***and***
  - If either parent entity or Alternate Reporting Entity (ARE) is resident in India; or
  - If parent entity is a non-resident and either of the following conditions are satisfied
    - Parent entity outside India has no obligation to file CbCR in its country / territory; or
    - Agreement for exchange of information has not been entered into between India and the country of the parent entity or ARE; or
    - India and the country of residence of the parent entity or ARE do not have DTAA
- Due date for filing CbCR in India is proposed to be extended to be within twelve months from the end of the reporting accounting period as compared to the existing due date of filing return of income

Transfer pricing – Clarifications to existing CbCR provisions

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- Due date for furnishing of CbCR by the ARE will be the due date specified in ARE's country or territory
- Reporting accounting year has been defined to mean the accounting year in respect of which the financial and operational results are required to be reflected in the CbCR
- These amendments are clarificatory and hence shall apply in relation to the AY 2017-18 onwards

INDIRECT TAX PROPOSALS

Overview of changes – Indirect taxes

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- No GST related announcements, as GST now under the domain of GST Council
- Rate of customs duty on some products such as mobile phones, smart watches and televisions increased to provide fillip to "Make in India"
  - Government had in fact already increased the customs duty on mobile phones to 15% in December 2017
  - Clear move towards increased localization efforts and backward integration
  - Overall protectionist proposals on the tax rate front – May have an impact on Indian exporters
- Abolition of 3% cess on imports (Education cess and Secondary and higher education cess) replaced by a levy of 10% Social Welfare Surcharge
  - Calculated only on BCD component
  - Majority of ITA goods exempted from Social Welfare surcharge
  - Marginal increase in customs duty paid by importers, where applicable
- Scope of assessment amended to cover classification, valuation, exemption or concession, quantity, weight and measure, origin and any other specific factor

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Overview of changes – Indirect taxes

- Some efforts around Ease of doing business, from a customs stand point
  - Payments permitted through electronic cash ledger
  - Timeline of 6 months prescribed for closure of assessments where no charges of collusion, willful mis-statement etc are invoked, 1 year in other cases
  - Time period to be notified for provisional assessment
  - Pre-notice consultation to be held with assessee in cases not involving collusion, willful mis-statement, suppression before issue of demand notice
- Scope of advance ruling expanded – Government can notify any other matter for seeking advance ruling
  - Appeal mechanism introduced as well
- Specific valuation provisions for levy of IGST for transfer of warehoused goods before clearance therefrom
  - Value to be adopted is higher of transaction value or value determined as per section 3(8) of Customs Tariff Act
  - Is this a precursor to address the possible double GST on bonded warehouse sales?

UPDATE ON GST ADVOCACY EFFORTS

GST Advocacy efforts

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- NASSCOM has been **engaged with the law makers since the release of the draft GST Law** – Some of the key wins
  - Sanction of 90% provisional refund envisaged in the law
  - Upfront exemption on goods and services procured by SEZ units
  - Relaxation provided in valuation rules for transactions between related party/ distinct persons
  - Deferment of TCS provisions and mandatory registration, for e-commerce
- Engagement with **Technology & ecommerce sectoral working groups**

Changes in law

  - Recognition of “contractual relationship” for determination of IT/ ITeS supplies in IT/ITeS FAQs
  - Clarification in FAQs on ISD provisions not being mandatory & changes to ISD now being available for reverse charge GST
  - Clarification on requirement of separate registration for SEZ units, statewise

Procedural aspects

  - Resolution of compliance issues around filing of “Letter of undertaking” for exporters
  - Relaxation in timelines for filing of returns

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GST Advocacy efforts

- Key recommendation before **Parliamentary Standing Committee on Exports**
  - Centralised registration and assessment for IT/ ITeS service providers
  - Continuation of upfront exemption for import procurements by STPI/ EOU units beyond March 2018 and extension of upfront exemption to domestic procurements as well
  - Exception to be carved out for HO-BO transactions
  - Place of supply in case of intermediary services
  - Lack of clarity on continuation of various schemes under FTP

GST Advocacy efforts

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- Report of **Parliamentary Standing Committee on Exports has addressed all key asks**

Issue	Recommendation by Committee
Upfront exemption for procurements by STPI/ EOU units	*"The Committee notes that temporary relief has been given to exporters till March 2018. However, this does not solve the problem of non refund of IGST on capital goods import. The IGST can only be adjusted against the payment of IGST on export side. The problem of locking up of capital on account of the GST/ IGST paid as well as accumulated ITC on import of capital goods remain as it is….* ***It is of the opinion that this arrangement of non-payment of IGST/ Cess till March 2018 should be made permanent**..* *The Committee recommends the Department of revenue to bring up issue of non refund of GST/ IGST and non refund of accumulated ITC on capital goods import as well as domestic procurement before GST Council on a urgent basis.." – Para 6.7 of the report*

GST Advocacy efforts

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Issue	Recommendation by Committee
Lack of clarity on continuation of various schemes under FTP	*“The Committee observes that limited utilization of Duty Credit Scrips issued under MEIS and SEIS schemes in GST regime has put a constraint on the working capital of exporters..* *The Committee* ***strongly recommends that the duty scrips may be permitted for payment of GST in domestic procurements and the payment of IGST on exports and imports of goods and services****” – Para 5.3 of the report*
HO-BO transactions – not to be made liable to GST	*“The Committee desires that the Government may revisit section 2(6) of the IGST Act and* ***ensure such transactions between the Head Office and its branches may be kept out of its ambit****” – Para 14.4 of the report*
Place of supply in case of intermediary services	*“Committee is of the view that following steps may be taken –* • *Provide that* ***Place of Supply of Indian Intermediaries of Goods will be the location of service recipient****, ie, customers located abroad (and not the location of such intermediaries as is currently provided) so that* ***Intermediary Services will be treated as ‘Exports****’*

GST Advocacy efforts

- NASSCOM would however continue with its efforts in the immediate future on some of the following key asks

Single registration and assessment for IT/ ITeS service providers, having multi state presence – Issue appears acknowledged* by both the Law Committee set up by GST Council as well as the MoF

Clarifications regarding taxability of HO-BO transactions

Extension of upfront exemption to STPI/ EOU beyond March 31, 2018 and extension of such benefit to domestic procurements as well

Resolution of procedural issues being faced including with respect to filing of returns, e-way bill etc

**As per news reports*

THANK YOU

You may send your feedback/suggestions to NASSCOM on

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Disclaimer

The objective of the session is to provide an update on the Union Budget 2018 based inputs from our knowledge partners Deloitte Touche Tohmatsu India LLP. This should not be construed as legal advise.