

NASSCOM®

Union Budget 2017

Impact on IT & ITeS Sector

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India's growth story

- Moves up 16 places to reach 39th rank on the World Economic Forum's Global Competitiveness Index 2016-17 - *Business standard: September 28, 2016*
- GDP expected to grow by five times to reach US\$ 10 trillion by 2030
- *Mr Arvind Panagariya, Vice Chairman, NITI Aayog*
- Ranked as the sixth largest manufacturing country after China, US, Japan, Germany and Korea - *United Nations Industrial Development Organization (UNIDO) report*
- Third largest technology driven start-up hub after the US and the UK
– *Study by Assocham, August 2016*

Macro-economic indicators*

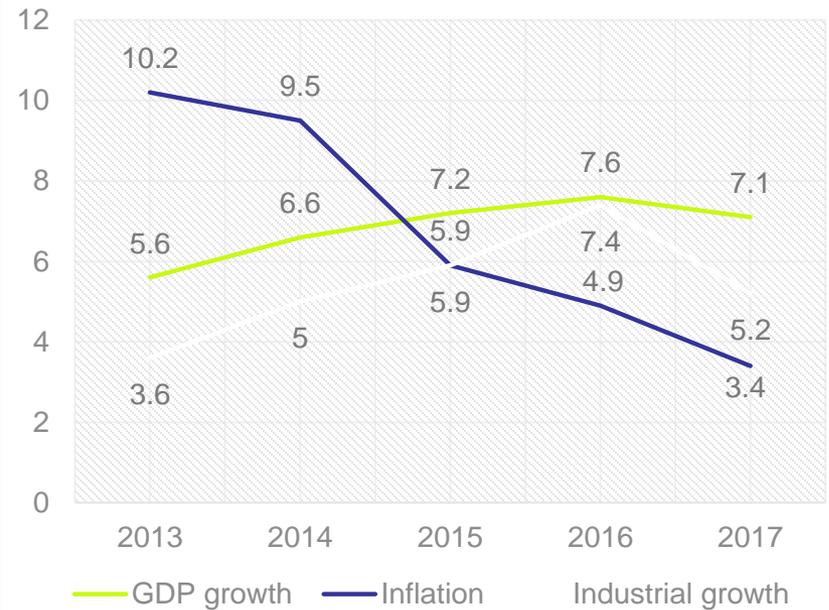
GDP growth rate

- 2016-17: estimated at 7.6%
- 2017-18: targeted at 7.1%

Inflation

- 2016-17: revised estimate at 4.9%
- 2017-18: estimated at 3.4%

Growth compromised in short term



*Source: Economic survey 2015-16, 2016-17

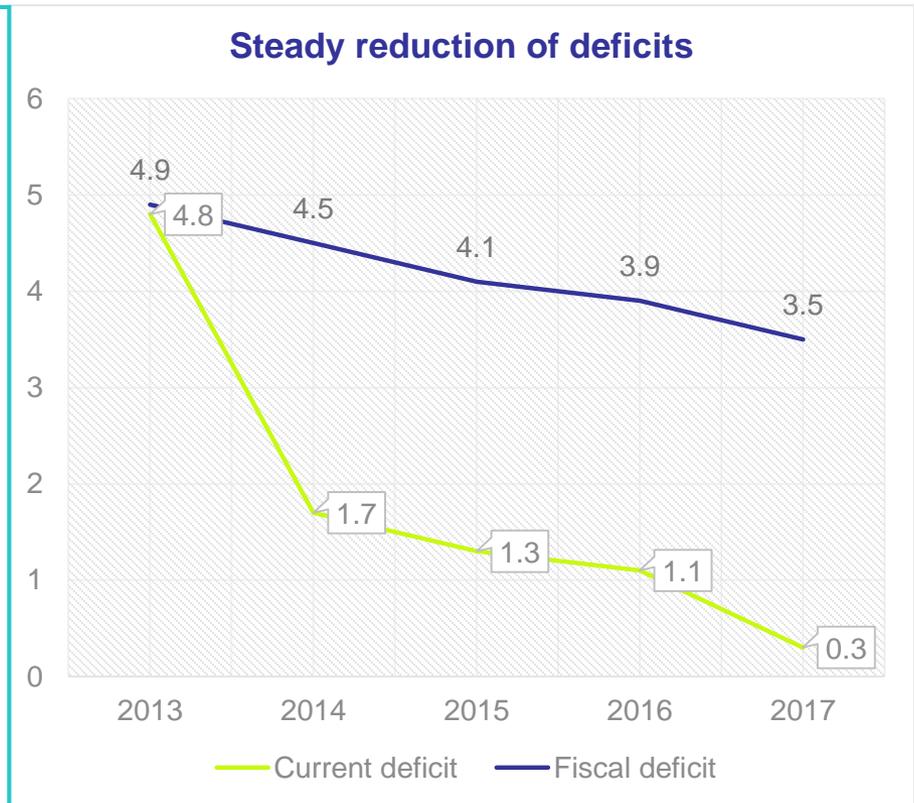
Macro-economic Indicators*

Fiscal deficit

- 2016-17: estimated at 3.9%
- 2017-18: targeted at 3.5%
- 2018-19: targeted at 3%

Current deficit

- 2016-17: provisional actual at 1.1%
- 2017-18: targeted at 0.3%



*Source: Economic survey 2015-16, 2016-17

IT – Key policy announcements

- Promoting Digital Economy and planned schemes around BHIM app, AadharPay, introduction of Point of Sale (PoS) terminals and the related fiscal and policy measures
- Payments Regulatory Board to be set up for regulation of digital payments
- Boosting electronics manufacturing through incentive schemes like Modified – Special Incentive Package Scheme (M-SIPS) and Electronic Development Fund (EDF)
- Proposal to simplify, rationalise and integrate labour laws
- New Cyber security regulator to be set up

Digital payments

- CERT for Financial Sector is essential for the growth of the digital payment ecosystem. Setting up is only the first step, as this needs to be strengthened and empowered.
- Review of the Payments and Settlement Act and setting up of the Payment Regulatory Board was a key recommendation of the Watal committee that has been accepted
- The Aadhar Enabled Payment System, another recommendation of the Committee, will be enabled via Aadhar Pay, invaluable for citizens without debit cards, mobile wallets or even mobile phones.
- NASSCOM will work with concerned departments of the government for implementation of the recommendations of the Watal committee report on Digital Payments.

DIRECT TAX PROPOSALS

Corporate tax rates

Entity	Effective rate of tax (in %)		
	Upto INR 10 mn	INR 10 n to INR 100 mn	Above INR 100 mn
Specified Companies*	25.75	27.55	28.84
MSME Companies#	25.75	27.55	28.84
Other domestic companies (existing corporate tax rate)	30.90	33.06	34.61

****Effective from Financial Year
(‘FY’) 2017-18***

**** Manufacturing companies not claiming specific deductions***

Companies with less than INR 500 Mn turnover in FY 2015-16 (increased from INR 50 mn in FY 2014-15).

MAT /AMT, DDT, BBT rates to continue. MAT/ AMT credit can be carried forward for 15 years

Announcements on Start-ups

- Relaxation in provisions relating to carry forward of losses
 - 51% shareholding condition prescribed u/s 79 of the Income-tax Act, 1961 ('the Act') done away with
 - Eligible start-up company allowed to carry forward and set-off losses incurred in the first 7 years only if all shareholders holding shares in the year of incurring losses continue to remain shareholders in the year the losses are set off
- Extension of tax holiday period under section 80-IAC
 - Eligible startups will be allowed a tax holiday for any 3 years in the first 7 years (previously 5 years) of their existence subject to other specified conditions such as:
 - Eligible start-up incorporated on or after April 1, 2016 but before April 1, 2019;
 - Turnover not exceeding INR 250 mn during the period April 1, 2016 to March 31, 2021; and
 - Certified as an eligible start-up.

Direct Tax announcements

TDS on call center business

- Withholding tax under section 194J on technical service fee to call centers – reduced to 2% from 10%
- Reduce cost of service

Minimum Alternate Tax ('MAT')

- Carry forward of MAT credit extended to 15 years from 10 years
- Alignment with IND-AS provisions
 - Particularly relating to treatment of Other Comprehensive Income
 - Carved out situations of actual profits on sale of investments – to be considered for MAT
- Limitation of MAT credit carry forward in case of foreign tax credit ('FTC') claim to tax computed as per the domestic law

Amendments for export transactions

Tax holiday under section 10AA

- Loss of non tax holiday unit must be set off against profit of tax holiday unit before claiming tax holiday benefit (deduction under section 10AA of the Act for Special Economic Zone units)
- Reverses Apex court decision in the case of Yokogawa India Ltd
- Prospective amendment
 - Applicable from FY 2017-18
 - Claims under the erstwhile tax holiday (Software Technology Park) regime not impacted

Foreign Tax Credit

- Credit for disputed taxes
 - Indian tax authorities to provide credit on settlement of dispute
 - Tax payer to furnish requisite documentation within prescribed timeline

Transfer pricing – Secondary adjustment

- Introduction of concept of secondary adjustment in line with international best practices
- Indian companies will need to bring into their books, and repatriate into India, the difference between the transaction price and arm's length price. Failure to do so will result in imputation of interest on such amount (secondary adjustment).
- The secondary adjustment will be applied where there is an adjustment to transfer price either through:
 - The taxpayer making a *suo moto* adjustment; or
 - Accepting a transfer pricing adjustment made during assessment; or
 - Accepting a safe harbor or an Advance Pricing Agreement/ Mutual Agreement Procedure resolution.
- No secondary adjustment if primary adjustment does not exceed INR 10 million or pertains to period prior to FY 2015-16
- Subsequent repatriation by the Indian company of such amounts brought into India will be subject to Dividend Distribution Tax

Domestic transfer pricing

Specified domestic transactions ('SDT')

- Domestic transfer pricing provisions will now only cover inter-company transactions where one or both the parties are involved in activities eligible for tax holidays
 - Payments to specified persons such as directors, parent and sister companies, etc would be excluded from domestic transfer pricing provisions
- Provisions applicable from FY 2016-17
- Likely to reduce compliance burden

Taxation of transfer transactions

Unlisted shares – Fair valuation

- Capital gains on sale of unquoted shares to be based on fair market value (FMV), if the sale price is lower than FMV – incidence of double taxation possible
- No exceptions carved out – can lead to undue burden
- Impact on transfer between unrelated parties?

Scope widened for taxation of transfer of any property without (or with inadequate) consideration

- Scope of taxation of transfer without, or inadequate, consideration widened:
 - all types of taxpayers included
 - all kinds of property covered
- This will essentially limit transactions such as “gifts” in the corporate context.

Place of Effective Management ('PoEM')

- Residency test for foreign companies in India
 - Final guidelines notified
 - Foreign Company resident in India if PoEM in India
 - PoEM means 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
- PoEM guidelines not applicable if turnover / gross receipts \leq INR 500mn in a financial year – Press release

Key Parameters

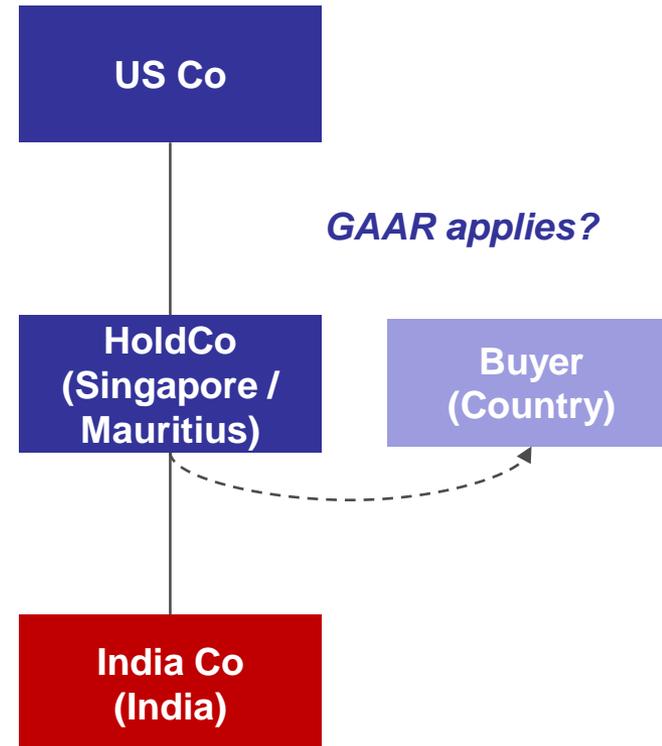
- 1 ***Substance over form***
- 2 ***Only “one” POEM***
- 3 ***Determined year on year basis***
- 4 ***Based on facts and circumstances***
- 5 ***Active vs. passive company determination***

Indirect transfers

- Indirect transfer provisions introduced in the Finance Act 2012 to tax sale of shares of a foreign company if such shares derives its value substantially from assets situated in India.
- Clarity relating to indirect transfer provisions
 - Provisions will not apply to investment held by non-resident, directly or indirectly, in a Category I /II registered FPI
 - Further clarifications expected on non-applicability of indirect transfer provisions to redemption of shares/ interest outside India arising out of redemption or sale of investment in India which is chargeable to tax
 - No specific carve out for PE funds
- Open issues:-
 - Treatment of convertible instruments
 - Definition of term 'liabilities'
 - Onerous reporting requirements

General Anti Avoidance Rules ('GAAR')

- Applicable from FY 2017-18 onwards
- To be implemented as part of comprehensive regime to deal with BEPS and aggressive tax avoidance
- Investments made before 1 April 2017 grandfathered – including bonus & right shares allotted post such date
- Clarifications issued recently to clear ambiguity
- Treaty renegotiations in 2016 – Mauritius, Cyprus, Singapore
- **GAAR to apply where SAAR applies /LOB conditions satisfied?**



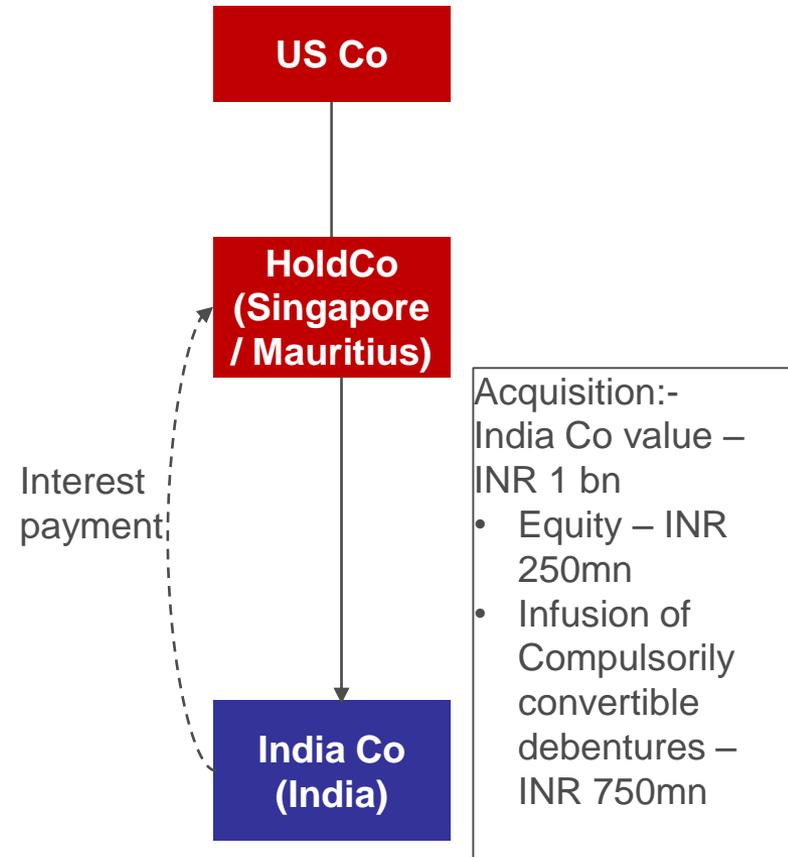
- Sale of shares acquired on 2 February 2017 post 1 April, 2017
- Conversion of preference shares / CCDs – post 1 April 2017
- Bonus issue – post 1 April 2017

Limitation of interest deduction

- Recommendations under BEPS Action Plan 4 introduced
- Limitation of interest deduction on payments to non-resident AEs
 - Applicable to Indian company and Indian Permanent Establishment ('PE') of foreign entity
 - Applicable even in cases of payment to unrelated parties to whom implicit or explicit guarantee has been extended/amount funded by the AE
 - To be triggered only when interest expenditure exceeds INR 10 mn
 - Excludes banks and insurance companies from its ambit
- Interest expense restricted to 30% of EBITDA (earnings before interest, taxes, depreciation and amortization) or interest paid/payable, whichever is less
- Carry-forward of unutilized interest allowed upto 8 years - tax arbitrage
- No corresponding provisions for limiting the withholding tax liability on the interest income
- Provisions applicable from FY 2017-18

Limitation of interest deduction

Particulars	Amount (INR mn) Year 1	Amount (INR mn) Year 2
EBIDTA	100	(20)
Interest expense (at arm's length) at 10% of INR 750 mn	75	75
Pre-tax profit	25	(95)
Benchmark ratio	30% of EBIDTA	30% of EBIDTA
Maximum interest deduction allowable	30	0
Disallowed interest carried forward	45	120



Other announcements

- Conversion of preference shares to equity – Exempt transfer.
- Section 194LC of the Act amended to extend the lower withholding rate of 5 % on interest payable on foreign currency denominated borrowings (including ECBs) with respect to borrowings made before July 1, 2020 (earlier July 1, 2017).
 - Similar benefit extended to Rupee Denominated Bonds (RDBs) including masala bonds
- Reduced capital gains tax rate of 10 percent chargeable to non-resident on transfer of unlisted securities to apply retrospectively from FY 2012-13
 - Ambiguity on applicable rate vis-à-vis residents now clarified
- Change in revenue audit timelines - substantially reduced for FY 2017 -18 and 2018-19 (18 months and 12 months respectively)
- Capital gains exemption on transfer of listed equity shares to be available for shares acquired after October 2004 only if STT was paid on acquisition
 - Introduced as an anti-abuse measure to avoid sham transactions
 - Exclusions for genuine transactions such as IPO, FPO, bonus or rights issue, acquisition of shares by non-resident in accordance with FDI policy to be notified

Other announcements

- Scope of taxation of dividend in excess of INR 1 Mn extended to all resident taxpayers except domestic company, institutions or universities covered under section 10(23C)
- Disallowance for failure to withhold tax extended to income from other sources
- Terms not defined under Tax Treaty to derive meaning from the domestic law or any explanation given by Central Government
 - Definition of the word 'process' under the domestic tax law

Personal tax proposals (1/2)

- Rate of income tax has been reduced to 5% (from 10%) for income between INR 2.5 to INR 5 lakhs. Similar reduction shall apply for senior citizens (60 years and above) for the slab of INR 3 to INR 5 lakhs. Other tax slab and rates remain the same.
- Tax rebate for total income upto INR 3.5 lakhs (earlier INR 5 lakhs) proposed to be reduced to INR 2,500 (from INR 5,000).
- Surcharge at a rate of 10% introduced for total income between INR 50 lakhs to INR 100 lakhs.
- Set-off of losses under the head “Income from House Property” against any other head of income restricted to INR 2 lakhs and the balance unabsorbed loss to be carried forward and set-off against “Income from House Property” for following eight years.
- Period of holding of an immovable property, to qualify as long term capital asset, has been reduced to 24 months (from 36 months).

Personal tax proposals (2/2)

- The base year for computation of capital gains for old capital asset acquired before April 1, 1981 has been moved to April 1, 2001. Now, the cost of acquisition of assets acquired before April 1, 2001, shall be allowed to be taken at the fair market value as of April 1, 2001
- Partial withdrawal from National Pension Scheme ('NPS') by any employee shall be exempt up to 25% of the contribution payable. The upper limit for deduction towards contribution to NPS increased to 20% (from 10%) of gross total income in case of individuals other than employees
- The deduction limit for cash donation under section 80G proposed to be reduced from INR 10,000 to INR 2,000
- Individuals (other than those subject to tax audit) paying rent of INR 50,000 or more per month or part of the month to withhold tax at the rate of 5% in the last month of the previous year or last month of tenancy, whichever is earlier.
- A simplified tax return form (one pager) is proposed to be introduced for individuals having taxable income (other than business income) up to INR lakhs

INDIRECT TAX PROPOSALS

Indirect Tax – Goods and Service Tax

- Finance Minister gave account of substantial progress vis-à-vis GST implementation:
 - Setting up of GST council and 9 progressive meetings thereafter
 - Consensus based decision making by the Council
 - IT preparedness on track
 - Awareness programs planned wef April 1, 2017

- No categorical re-affirmation of July 1, 2017 as implementation date
 - Few exemptions made to Customs, Central Excise are till June 30, 2017 which indirectly suggest GST implementation post such date
 - Awareness programs planned from April 1, 2017

Indirect Tax – Repeal of R&D Cess Act

- Proposed repeal of Research and Development Cess Act, 1986 effective April 2017
 - IT service providers involved in making payments towards import of technical know-how, trademark, intellectual property, etc
 - Payments towards import of technology would no longer attract non-creditable R&D cess
 - Impetus to domestic manufacture of various goods involving foreign technology

Indirect Tax amendments - Customs duty

Mobile phones manufacture - Import of populated PCBs

- SAD exemption on import of populated PCBs for manufacture of mobile phones withdrawn
- SAD at 2% made applicable on populated PCBs for use in manufacture of mobile phones till June 30, 2017, post which SAD at 4% will be applicable
- The said amendment was introduced in the previous Budget. However, the proposal was withdrawn after industry representation, and is now being reintroduced

Indirect Tax amendments - Customs duty

Encouragement of e-payments / cashless transactions

- BCD, CVD (consequently SAD) and ED exemption provided on import / manufacture of following products:
 - Micro ATMs as per standards version 1.5.1
 - Fingerprint reader / scanner
 - Iris scanner
 - Miniaturised POS card reader for mPOS (other than Mobile phone or Tablet Computer)
 - Parts and components for use in the manufacture of the above goods (subject to actual user condition)

- ED and CVD exemption valid upto June 30, 2017

Indirect Tax amendments - Customs duty

- Concept of 'Beneficial owner' inserted (*person on whose behalf goods are being imported or exported or who exercises effective control over such goods*)
 - Position vis-à-vis obligations and entitlements of importer / exporter needs to be evaluated
- Unjust enrichment conditions not to apply in certain cases of excess customs duty paid prior to clearance for home consumption
- Timelines for filing bill of entry and payment of duty revisited - Penal charges for delay beyond revised timelines

Recent changes – Digital supplies by non-resident service providers

- Scope of Online Information Database Access or Retrieval services expanded to include-
 - Advertising on internet
 - Cloud services
 - Online supplies of digital content
 - Download of e-books, movies, music, software and other intangibles
 - Services whose delivery is mediated by IT over internet with minimal human intervention
- Non-resident service providers liable to take registration and pay taxes in case of supplies to B2C or B2G or other customers not having service tax registration in India
- Amendment to service tax law effective from December 1, 2016

Recent changes – Digital supplies by non-resident service providers

Issues being faced

- Bifurcation of service tax into tax and various cess in the invoice
- Signing (including digital signature) the invoice – Requirement relaxed till February 1, 2017
- Applicability of provisions to supply of Indian application developers through global intermediaries
- Clarity on role of agent – Service provider eligible to appoint agent to undertake compliances on his behalf
- Filing of half yearly returns – Detailed requirements to be uploaded in the half yearly return including detailed listing of invoices, service tax registration numbers, etc prescribed
- No provision to disclose or adjust credit notes issued to customers

**NASSCOM continuing its engagement with Revenue Authorities
for resolving the above issues**

Recent changes – Amendment to Aggregator service liability

➤ Definition of Aggregator amended

- Any person engaged in enabling a potential customer to connect with persons providing services by way of renting of hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes, shall not be included within the definition of aggregator

➤ Conditions applicable for above exclusion

- Service provider (ie, hotel, inn, guest house, club or campsite, as the case may be) should have a service tax registration; and
 - Consideration for such services (ie renting or lodging services) is directly received by the service provider and no part of consideration for such services is received directly by the aggregator from the service recipient or his representative
- Relief only for aggregators / travel portals / agents where customers pay hotels directly – NASSCOM recommendation accepted

Recent changes – Amendment to Aggregator service liability

Issues

- Debate whether hotels booked through Online Travel Agents (OTAs) are in nature of aggregator continues where full payment is made by customers to OTAs
- Issue of non-availability of credit on commission paid to the owner of the web based software application when aggregator provisions are applicable which leads to double taxation still remains

NASSCOM continuing its engagement with Revenue Authorities for resolving the above issues

Recent changes – Tour operator services – Reduction in abatement percentage

➤ **Services by Tour operators**

- Abatement in relation to arranging for accommodation reduced from 90% to 60% - Effective service tax rate increased to 6% from 1.5%
 - Abatement in relation to other services reduced from 70% to 60% - Effective service tax rate increased to 6% from 4.5%
- Affects OTAs and travel portals involved in arranging tours for customers booking online through the website

Issues unaddressed

- R&D Benefits for the IT sector – Section 35(2AB)
- Removal of angel taxation for all start-ups
- Lowering TDS rate for all software payments
- Need to allow carry forward of Foreign tax credit
- Provide credit on equalisation levy
- Legacy issues of Indirect taxes before implementation of GST

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