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Union Budget 2017 – Proposals and impact on IT/ITeS sector

The budget scores high on intent, targeting country's priorities. However the IT sector's expectations for support for innovation and export competitiveness remain unmet.

Medium and Small Enterprises are instrumental in providing employment to people. Proposals for reduction of income tax to 25% for companies with annual turnover upto 50 crore will be helpful. Further, encouragement by Government for Small Industries Development Bank of India (SIDBI) to refinance credit institutions which provide unsecured loans, at reasonable interest rates, to borrowers based on their transaction history, is likely to benefit IP driven businesses who rarely have strong collaterals to offer as guarantee.

The continued focus on digital payments is as per expectations. We welcome the Government's announcement of setting up the Payments Regulation Board and the intent to comprehensively evaluate the Payments and Settlement Systems Act. Related and extremely critical is security and setting up of Computer Emergency Response Team (CERT) for financial transactions announced, needs to be expedited and suitably empowered to raise confidence in digital transactions.

Reinforcement of Government's intent to rationalise regulations and in particular labor laws will have far reaching effect in ease of doing business and protecting employee interest. IT sector in particular has been requesting for changes in light of its business models and employee profile. NASSCOM will continue to engage with the State and Centre in this regard.

The Technology sector sees many emerging opportunities arising out of Government reliance on Technology driven development e.g. initiatives like SWAYAM, separate policy for Metro with focus on indigenisation, Pension platform for defence, Digi Gaon etc. It is for the startups and Industry to exploit such opportunities and contribute to national objectives.

For startups, extending the time period for eligibility for the 3 year income tax exemption has been increased from 5 years to 7 years. To support investments and scaling up of startups, the Government has changed the provisions for carry forward of losses even if stakes are diluted beyond the stipulated 51%, if original stakeholders continue to hold shares. The provisions are seen to be restrictive and in fact may seem more onerous than what is existing today.

We will continue to engage with the Government to make these announcements effective and also on other unaddressed recommendations related to harnessing domestic and angel investors to strengthen the start-up ecosystem.

Specifically for the IT sector, Tax deducted at source (TDS) on payments to call centres have been reduced from 10% to 2%. This will improve working capital situation and potentially support the all India Business process outsourcing (BPO) Support scheme of the Government, where cos are setting up in Tier 2/3 locations. Unfortunately, all other software transactions continue to be subject to 10% TDS, despite Industry demand for lower TDS.

Foreign tax credit (FTC) is an important tax provision for the IT sector given their widespread global operations. The budget addresses one of the concerns of the sector related to tax disputes abroad and related FTC in India. The budget enables claim of credit within 6 months from the end of the tax dispute settlement, thereby reducing double taxation incidence on companies.

There have been misses as well, and primary amongst them are Safe harbour margins for the IT sector continue to remain unrealistic and therefore have limited adoption.

Amongst concerns, aggressive transfer pricing (TP) assessments remain unaddressed. Additional requirement to repatriate increase in income or reduction in loss, due to TP adjustment, within specified time frame, further increases complexity of the TP regime.

The Technology sector has sought support and incentives for R&D,that has been ignored. However, we hope that the increased allocation in the S&T ministries will find a way to support the Industry.

Key Highlights

- Reliance on technology for achieving development goals reinforced
- Continued focus on digital payments was expected and will create opportunities for the sector
- Start-ups have received attention to make the startup India action plan more effective from an income tax exemption perspective, but a lot remains and we are hopeful the fine print may have some good surprises.
- Honoring the Honest in Tax administration, and the RAPID (Revenue, Accountability, Probity, Information and Digitisation) approach of the revenue welcome.

Digital payments - acceptance of some recommendations of the Watal Committee welcome.

- 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 Wattal 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.

For IT – Emerging business opportunities and some positives

- TDS on payments to call centres reduced from 10% to 2%. This will improve working capital and potentially support the all India BPO Support scheme of the Govt, where cos are setting up in Tier 2/3 locations.
- Faith in technology continues, as web based platforms and digitalisation initiatives referred to, will create opportunities for the sector in the long term e.g. SWAYAM, Metro policy, Pension platform for defence, Digital payments, Digi Gaon etc.
- Towards a harmonious regulatory environment – Government plans legislative reforms to simplify existing labour laws -- wages, industrial relations, social security and safety
- Relief for exporters from Special Economic Zones (SEZs) – Increases period for Minimum Alternate Tax (MAT) credit carry forward by 5 years to 15 years
- Towards Make in India – Increased allocation of Modified Special Incentive Package Scheme (M-SIPs) and Electronics Development Fund (EDF) to create opportunities for the sector.
- Increased allocation of scientific Ministries (Department of Science and Technology and Ministry of Electronics and Information Technology) NASSCOM will work on proposed measures to support transition of the Indian IT sector in the digital age.
- Research & Development cess act repealed is likely to bring down technology / IP acquisition cost for service companies as well as manufacturers who import technology.
- Foreign Tax credit – If there is a tax dispute in other country, earlier no tax credit was available. Now, credit adjustments will be allowed within 6 months from the end of the dispute settlement.

- Research and Development Cess Act, 1986 is proposed to be repealed. Reduction in tax cost to the extent of 5% (R&D cess) on technology imports. Subsequently, service tax at 15% to be paid in full.

Concerns and Unfortunate Misses

- **Start-ups - Steps towards making Start-up India program more effective**
    - Extension of the eligibility period of 3 consecutive years of income tax exemption from 5 years to 7 years from its incorporation.
    - Carry forward of losses if original shareholders continue despite change in shareholding pattern < 51%.

  A comprehensive reading of these conditions make the applicability of these provisions ambiguous and restrictive and they do not achieve the intended relaxation.

- **Concern on change in Transfer pricing provisions:** As a result of primary adjustment to the transfer price, if there is an increase in the total income or reduction in the loss, the companies are expected to repatriate that income within a specific time, else it will be treated as an advance and interest will be computed etc. In the absence of practical safe harbor margins, this can prove to be restrictive for many MNC IT companies operating in India.
- **Budget proposed Fair Market Value to be full value of consideration in for capital gains in certain cases** – If consideration for transfer of share of an unlisted company is less than the Fair Market Value (FMV) as determined then for purpose of capital gains taxation, the FMV will be considered.
- No R&D support scheme – critical for manufacturing and technology sectors. IT sector continues to be excluded from existing schemes. In view of the rapid technology changes and need for innovation, as the IT sector moves up the value chain, battles global trade barriers, an incentive structure for R&D would have proved extremely critical for long term success.
- Safe harbour margins continue to be high and unrealistic, and therefore difficult to adopt. In light of the transfer pricing changes made above that require repatriation of the income attributed on assessment, it becomes all the more imperative that margins are revised.
- While tax relief to SMEs is welcome (corporate tax rate reduced to 25% for companies with an annual turnover upto INR 50 crores) however there is no visibility of roadmap for corporate tax rate reduction as proposed in budget 2015.
- Angel tax on non-innovative startups continues
- Tax disparity on angel and domestic investors continues.

Various other announcements

S. No	Category	Announcement	Implication
1.	**Digital Economy**	Two new schemes to promote the usage of BHIM; Referral Bonus Scheme for individuals and a Cashback Scheme for merchants.	Promoting digital payments
		Proposal to mandate all Government receipts through digital means, Beyond a prescribed limit, is under consideration.	
		Banks to introduce additional 10 lakh new Point of Sales (POS) terminals by March 2017.	
		E-market place for procurement of goods and services	
		No cash transaction above Rs. 3 lakhs, with certain exceptions	
2.	**Railways**	Service charges/ tax for ticket booking on IRCTC withdrawn	Lower cost
		New Metro Rail Policy with focus on innovative models of implementation and financing, as well as standardisation and indigenisation of hardware and software	Business opportunity
` **3.**	**Education**	Innovation Fund for Secondary Education	Business Opportunity
		SWAYAM platform with at least 350 online courses to enable students to virtually attend courses taught by the best faculty.	
4.	**Agriculture and Rural**	Support for NABARD for computerisation and integration of all 63,000 functional Primary Agriculture Credit Societies with the Core Banking System of District Central Cooperative Banks.	Business Opportunity
		Coverage of National Agricultural Market (e-NAM) to be expanded from 250 markets to 585 APMCs	
		A DigiGaon initiative will be launched to provide tele-medicine, education and skills through digital technology	
		High speed broadband connectivity on optical fibre will be available in more than 1,50,000 gram panchayats, under BharatNet	

S. No	Category	Announcement	Implication
5.	**Ease of Business**	Legislative reforms will be undertaken to simplify, rationalise and amalgamate the existing labour laws into 4 Codes on (i) wages; (ii) industrial relations; (iii) social security and welfare; and (iv) safety and working conditions.	
		Foreign Investment Promotion Board to be abolished in 2017-18 and further liberalisation of FDI policy is under consideration	
		to protect the exemption for genuine cases where the Securities Transactions Tax could not have been paid like acquisition of listed share in IPO, Follow on Public Offer (FPO), bonus or right issue by a listed company acquisition by non-resident in accordance with Foreign Direct Investment (FDI) policy of the Government etc., it is also proposed to notify transfers for which the condition of chargeability to Securities Transactions Tax on acquisition shall not be applicable	
6.	**Citizen Welfare**	Aadhar based smart cards for senior citizens	
		Web based interactive pension disbursement system for defence personnel	
		Online centralised defence travel system	