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Thought Leadership

# india BUDGET 2008

Impact on Technology Sector



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## FOREWORD

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The IT / ITES sector continues to play a significant role in India's economy. The past year has witnessed a revalidation of the Indian IT / ITES sector encompassing a wide spectrum of services from IT consulting to back office service, package implementation, systems integration, driven by a maturing appreciation of India's role and growing importance in global services trade.

Thanks to the Indian IT / ITES sector, the world, even today, acknowledges India as an "IT Superpower". This is also evident from the continued interest evinced by foreign players in setting shop in India to tap the huge IT talent pool that India has to offer. As per a NASSCOM report, China (India's close competitor in the IT / ITES space) is unlikely to bear on India's lead in global services sourcing in any manner for a few more years to come.

The country's high-growing IT sector, which is under pressure due to sharp appreciation in rupee and slowdown in the US economy was expecting a fresh lease of life from the Budget. In the run up to the Union Budget 2008, like any other sector, the IT / ITES sector too has its share of expectations from the Finance Minister, with the hope that some of them would be addressed, particularly, relating to the extension of tax holidays.

This alert provides an insight into the industry's expectations from the Union Budget 2008 and also summarises the key direct tax and indirect tax proposals in the Union Budget 2008 relevant to the industry.

# BUDGET EXPECTATIONS

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The key industry expectations from Budget 2008 were:

## Income tax

### **Extension of tax holiday period for IT / ITES companies**

IT / ITES companies (operating as STPI / EOU units) currently enjoy an income-tax holiday on the profits from export revenues as per the provisions of section 10A / 10B of the IT Act. The tax holiday period has a sunset clause as per which tax holiday would end on March 31, 2009.

To mitigate the impact of the appreciating Rupee (against the US Dollar), to enable it to maintain its competitive edge and to provide a level playing field with the SEZ units, the IT / ITES sector expected an extension of the tax holiday period, particularly to offer protection to the small and medium players in the sector.

### **Advance Pricing Arrangements and stable transfer pricing policy**

The high pitched transfer pricing audits being faced by captive IT / ITES companies has raised transfer pricing to be the single largest tax concern for multinationals in India. In order to enable faster resolution of transfer pricing issues and provide certainty and predictability, companies were seeking the introduction of an APA mechanism.

### **Simplification of fringe benefit tax provisions**

The sector expected a reduction in the rigour of the FBT levy vis-à-vis exclusion of genuine business expenses from the purview of FBT. The sector also expected more clarity surrounding the levy of FBT on ESOPs and various issues connected therewith.

### **Other key expectations**

Other key expectations of the sector were clarifications on the manner in which the SEZ unit tax holiday would be worked out and increase in the MAT carry forward period.

## Indirect taxes

### **Faster refunds for ITES service exporters**

Service tax rebate provisions for ITES services exporters were introduced in April, 2005. However, there has been prolonged debate and dispute on the matter. Given that most of the rebate applications were not yet processed, it was expected that an instruction would be issued for expedited processing of refunds.

### **Consolidated definition for “information technology services”**

There are several taxable service categories and exemptions in the service tax law for services relating to information technology. Given the complexities in classification of same and to avoid disputes, it was expected that a consolidated definition would be introduced for all “information technology services”.

### **Maintain excise duty rate on computer hardware**

The recent years have seen frequent change in the excise duty rate on computer hardware and valuation of these products. Industry was seeking that there be no modification this year on these products.

### **Amendments to Export of Service Rules**

The Export of Service Rules have a condition that services need to be “used outside India” to qualify to be “export services”. Further, with respect to several information technology related services, the test for export is based on place of performance of the services and not on the criteria of the service recipient being situated outside India.

Industry expected an amendment to the Export of Service Rules for removal of the test of usage. Further, there was an expectation that all information technology related services should have only a simple test of the service recipient being situated outside India and consideration being received in foreign exchange.

# BUDGET PROPOSALS

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## Income tax

### Taxable income and tax rates

- No changes in the basic corporate tax rate structure and MAT rate – corporate tax rate (including surcharge and cess) for domestic companies remains at 33.99 percent and for foreign companies at 42.23 percent; MAT rate continues to be 11.33 percent (including surcharge and cess)
- DDT rate continues to be 16.99 percent (including surcharge and cess)
- No extension of tax holiday period for STPI / EOUs – sunset clause retained at March 31, 2009
- Changes to the MAT provisions vis-à-vis computation of book profit – deferred tax charge, DDT, surcharge, education cess and interest under the IT Act would be added back to determine book profits for MAT purposes

### FBT

- FBT on ESOPs recovered from employees is deemed to be tax paid by such employees
- Expenditure on prepaid electronic meal cards and guest houses are now outside the purview of FBT
- Expenditure incurred on providing first aid facilities to employees, creche facility to employees' children, on organising sports events for employees and on sponsoring sportsperson who are employees are also outside the purview of FBT
- The amount for levy of FBT on expenditure incurred on festival celebrations has been reduced from 50 percent to 20 percent of the expense

### Other key amendments

- Increase in short-term capital gains tax rate in case of listed securities to 15 percent

- Due date for filing corporate tax / FBT returns has been advanced to September 30 from October 31
- Reduction in the DDT liability to ultimate Indian holding companies distributing dividend to its shareholders - the amounts received as dividend from the subsidiary companies, on which DDT has been paid by the subsidiaries, would now be available as a reduction from the base on which the Indian holding company is liable to pay DDT – Indian holding company defined to mean Indian company holding more than 50 percent of the nominal value of the equity share capital of such subsidiary
- Requirement of issuing TDS certificates has been extended up to March 31, 2010 – however, enabling provisions have been put in place to strengthen the e-system of granting TDS credit
- The power of ITAT to grant stay beyond 365 days has been withdrawn

## Service tax

### New services

- A new category of “Information technology software services” has been introduced to include the following:
  - Development, study, analysis, design and programming of IT software;
  - Adaptation, upgradation, enhancement, implementation and other similar services in relation to IT software;
  - Provision of advice, consultancy and assistance on matters relating to IT software; and
  - Acquiring right to use IT software for commercial exploitation and right to use IT software supplied electronically.
- Consequent to the amendment, the following amendments to existing service categories were also made:
  - The exclusion to computer software engineering related services has been omitted from the category of “consulting engineering services”
  - The exclusion to “information technology services” under the category of “business auxiliary services” has

- been omitted
  - “Technical testing and analysis services” amended to include testing or analysis of IT software
  - “Technical inspection and certification services” amended to include inspection, examination and certification of IT software
- A new category for “Supply of tangible goods for use” has been introduced. This category applies where there is a supply of tangible goods for use without transferring right of possession and effective control of such goods. Circular clarifies that this service category would be applicable where there is no VAT leviable on such supply.

Pursuant to the Finance Bill being passed, the new taxable service categories would come into force on a specified date to be notified.

## **Provisions on Export and Import of Services**

- Export of Service Rules, 2005 amended to provide that in case the following services are provided in relation to goods or material or immovable property located outside India at the time of provision of the service, then whether the service is performed in India or outside India, the service shall be treated as taxable service performed outside India:
  - Management, maintenance or repair services;
  - Technical testing and analysis services; and
  - Technical inspection and certification services.
- This is subject to the services being provided remotely through internet or any electronic network including a computer network or through any other means
- The converse of the above would be applicable to Taxation of Services (Provided from outside India and Received in India) Rules, 2006, ie, the Import Rules
- These amendments shall be effective from March 1, 2008

## Other key amendments

- Amendments to transactions between associated enterprises, wherein
  - “Gross value of service” includes any amount credited or debited to any other person in the books of accounts;
  - Provision also applies to reverse charge under section 66A of the IT Act;
  - Definition of “associated enterprises” under IT Act made applicable; and
  - Issue on timing of payment on service tax on such transactions.
- Annual threshold limit increased from Rs 0.8 million to Rs 1 million with effect from April 1, 2008
- Time limit for filing of revised returns extended from 60 days to 90 days from date of submission of the return
- Self adjustment of excess service tax paid increased from Rs 50,000 to Rs 100,000 for a relevant month or quarter
- The rate of service tax for works contracts under Works Contract (Composition Scheme for Payment of Service tax) Rules, 2007 has been increased from 2 percent to 4 percent with effect from March 1, 2008
- Provisions for best judgment assessment introduced, where taxpayer fails to file return or assess the tax, after allowing taxpayer to represent his case

## Customs duty

### Changes in customs duty

- There is no change in peak rate of customs duty
- Exemption from basic customs duty on import of certain inputs/ raw materials used in the manufacture of IT / electronic hardware items such as connectors, semi-conductors, plasma displays, etc, to provide level playing field for domestic manufacturers
- Import of SMPS power and IR module used in the manufacture of set top boxes exempt from basic customs duty

- A duty (ie, NCCD) of 1 percent imposed on import of mobile phones
- General project import rate has been reduced from 7.5 percent to 5 percent

## Excise duty

### Changes in excise duty rates

- Excise duty rate reduced from 16 percent to 14 percent
- Excise duty on packaged software increased from 8 percent to 12 percent on par with the customised software liable to service tax at 12 percent
- Excise duty on wireless data modem cards exempt
- A duty (ie, NCCD) on mobile phones introduced at 1 percent
- Rate of duty for clearance of goods from EOU/ STP/ EHTP to DTA has been revised from 25 percent of BCD + excise duty to 50 percent of BCD + excise duty
- The rate of abatement for MRP based valuation of IT products has now been reduced marginally
- Excise duty exemption for goods manufactured in Uttarakhand and Himachal Pradesh shall now extend to single function printers and monitors

### CENVAT Credit

- Rule 3 of CENVAT Credit Rules, 2004 has been amended to allow use of capital goods outside the premises of the service provider without any time restriction, on condition that same is used for providing output services
- Rule 6 has been amended to provide the following options to manufacturer of excisable and exempt goods or provider of taxable and exempt services having common input/ input services and not opting to maintain separate accounts:
  - Pay an amount equal to CENVAT credit attributable to inputs / input services used in or in relation to manufacture of exempt goods or provision of exempt

- services subject to prescribed procedure; or
- Pay 10 percent on value of exempt goods or 8 percent of value of exempted services
- Rule 7A inserted to provide for availment of credit on capital goods / inputs transferred interoffice based on invoice / bill / challan

## CST and GST

- CST proposed to be reduced from 3 percent to 2 percent from a date to be notified
- It has been restated in the Budget speech that the Government is on track for introduction of a National GST in 2010

## GLOSSARY

APA	Advance Pricing Arrangement
BCD	Basic Customs Duty
BPO	Business Process Outsourcing
CENVAT	Central Value Added Tax
CST	Central Sales Tax
DDT	Dividend Distribution Tax
EHTP	Electronic Hardware Technology Park
EOU	100 percent Export Oriented Unit
ESOP	Employees Stock Option Plans and other similar Plans
FBT	Fringe Benefit Tax
GST	Goods and Services Tax
IR	Infrared
ITAT	Income-tax Appellate Tribunal
IT Act	Income-tax Act, 1961
IT	Information Technology
ITES	Information Technology Enabled Services
MAT	Minimum Alternate Tax
MRP	Maximum Retail Price
NCCD	National Calamity Contingent Duty
SEZ	Special Economic Zone
SMPS	Switch Mode Power Supply
STPI	Software Technology Parks of India
TDS	Tax Deducted at Source



[www.bmradvisors.com](http://www.bmradvisors.com)

#### OUR CONTACTS

**New Delhi:** The Great Eastern Centre, First Floor, 70 Nehru Place, New Delhi 110 019.  
Tel: + 91 11 3081 5000. Fax: + 91 11 3081 5001.

**Mumbai:** 3F, Contractor Building, 41 R Kamani Marg, Ballard Estate, Mumbai - 400 001.  
Tel: + 91 22 3021 7000. Fax: + 91 22 3021 7070.

**Bangalore:** 2nd Floor, Embassy Icon Annexe, 2 / 1, Infantry Road, Bangalore 560 001.  
Tel: + 91 80 4032 0000. Fax: + 91 80 4032 0001.

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