

## **SECTOR FOCUS: IMPACT OF UNION BUDGET 2006-'07 ON IT INDUSTRY**

- **New Policy initiatives to promote 'Destination India'**
- **Computer Manufacturers Welcome Re-imposition of Excise Duty**
- **Domestic BPOs Come Under Service Tax Net**
- **Special Thrust on e-Governance to Bring New Business Opportunities**

The Union Budget '06-'07 was presented by Mr. P Chidambaram, India's Finance Minister, in the Indian Parliament on February 28, 2005. The budget portrays a positive outlook aimed at maintaining the current momentum of growth in the economy, which stands at 8% per annum.

One sector which continues to be closely observed is the Information Technology (IT) sector. While The Finance Minister has extended a fair share of incentives, he has brought some parts of the sector under the tax net. The IT Services companies may feel contented that the tax exemptions to the sector stay put and the fringe benefit tax (FBT) rules have been relaxed. The budget is also favorable for domestic hardware assemblers. But the BPO companies would feel the pinch as the domestic call center business has come under the service tax net.

NASSCOM, the industry body representing about 900 Indian IT companies, has welcomed the changes in the Fringe Benefit Tax, particularly the reduction to 5% for some heads for which the BPO sector was earlier paying 20%. A section of industry, however feels that the changes in FBT have fallen short of expectation. The industry is not pleased with the proposal of hiking the rate of Minimum Alternate Tax (MAT) from 7.5% to 10% (increase of 33.33%). MAT is imposed on those profitable companies, whose income goes fully untaxed otherwise because of several exemptions.

### **Computer Hardware: New Policy initiatives to promote 'Destination India'**

The IT manufacturing industry has welcomed the policy initiatives announced by the Finance Minister to boost manufacturing of capital-intensive hardware products such as Semiconductors, Assembly, Testing and Packaging of Semiconductors, LCDs, storage devices, etc. The Government intends to make India the manufacturing hub for these high-end technology products.

In order to create a window to provide equity participation and/or viability gap funding to the new ventures, the government plans to use the existing vehicles of viability gap funding and India Infrastructure Finance Company Limited (IIFCL), a 100% state-owned entity created for funding infrastructure projects. This move is expected to help in developing the small and medium scale ICT manufacturing entities in the domestic market. The detailed proposal to provide equity participation and/or viability gap funding will be announced soon.

The Government has also proposed to set up separate townships targeting industries like information technology (IT). The metro cities have not been able to keep pace with the growing infrastructure needs of IT and ITES companies. The above initiative will help spread the IT growth story to smaller cities and ease the pressure of increasing infrastructure costs for these companies.

### **Computer Hardware: Will Excise Duty Hike make Domestic Manufacturers Globally Competitive?**

The Finance Minister has levied 12% excise duty on computers. The industry has welcomed the move as it increases the competitive advantage of domestic manufacturers' vis-à-vis imports. They can now avail of credit of excise duty paid on inputs.

The imposition of the excise duty rectifies the inverted duty structure that was not in favour of local manufacturers. Earlier, the finished computer hardware had zero excise duty, but the average duty on the inputs stood at 11%-12%. Due to the finished product being fully exempt, the manufacturers were in no position to take credit of the duty paid on the inputs.

Now, with 12% excise duty on the finished product, they can take credit of the 11%-12% duty paid on the inputs. Even if the duty paid on the inputs is less than the 12% excise paid on the finished product, the manufacturers can now offset the excise duty on import of spares and the Service tax on services consumed for manufacturing.

#### **Increase in consumption expected**

The move to impose the excise duty on the finished products is also expected to help in

increasing consumption in the business segment. The excise duty will lower the cost of purchase to the manufacturing industries or the service sector companies. With excise duty on the computers, the manufacturing and the service industries can offset this excise duty on the purchase of computers against their own excise or service tax as applicable.

#### **Imported computers to become dearer**

The imported computers, on the other hand, are going to become slightly dearer because of duty changes. The total duty has gone up from 11% to 16%. Earlier it was 0% CVD (Countervailing Duty) along with 7% additional duty and another 4% additional duty totaling to 11%. Now it has been changed to 12% CVD plus 4% additional duty totaling to 16%. However, a portion of the addition burden of 5% extra duty may get offset for the duties paid on the parts imported for maintenance and services offered by the same company to its customers, if any. Therefore, the net burden on the imported computers should not be very significant.

#### **Software Products: Hard Surprise**

In the Union Budget the Finance Minister also proposed imposing an excise duty of 8% on the packaged software.

The proposal came as a surprise for the software industry. NASSCOM, the industry body representing more than 900 Indian IT services companies, explained that the imposition of the excise duty will have a negative impact on the domestic IT market. Higher prices will hinder the efforts to promote IT utilization in the Indian economy across verticals like education, health, etc.

NASSCOM has appealed to the Finance Minister to correct this aberration. A different section of the industry, however, believes that it may not impact the overall IT purchases as the buyer companies may set off the additional burden by taking credit on the excise duty paid on the packaged software purchases against their own duty liabilities. Earlier also, the packaged software import was not totally duty free, as it was subjected to CVD.

#### **Domestic BPOs Under Service Tax Net:**

Domestic call center business has been brought under service tax ambit. According to NASSCOM, it will not only raise costs, but will act as a deterrent to outsourcing work to SMEs.

Earlier, call centres and medical transcription centres providing service to customers in India or receiving payment in Indian rupees were exempted from the service tax. Now they will have to pay service tax at the rate of 12%.

#### **Government to Spend More on e-Governance:**

The Finance Minister also announced the National e-Governance Plan under which 25 projects will be rolled out in the year 2006-'07. The plan will be approved shortly.

Among them is Project MCA-21 to enable companies to file returns electronically. The project also involves setting up common service centres and assigning unique ID to Below Poverty Line (BPL) families.

It is Government's intention to bring a number of services online, in a web-based mode, including applications under the Right to Information Act, applications for house sites, ration cards, transfers of teachers, inclusion in the electoral roll, filing of police complaint, and issue of birth/death certificates and copies of land records.

Roll out of these e-Governance initiatives is bound to open new business opportunities for the IT/ITES companies.