BUDGET 2009-10 hugely Disappointing For The Information Technology Industry – July 7, 2009

BUDGET 2009-10 : HUGELY DISAPPOINTING FOR THE INFORMATION TECHNOLOGY INDUSTRY: By S Sivakumar, CA

1. The sunset clause under Sections 10A and 10B of the Income tax Act, which provides exemption to STP Units, has been extended to March 31, 2011. It is to be remembered that only the sunset clause has been extended. The overall period of tax exemption at 10 years remains. It would have been good if the sunset clause had been extended for a longer period, which would given time for the IT industry to plan out their taxes.

2. Fringe Benefit Tax is abolished. On the face of it, it's some good news for corporates in general and IT companies, in particular. However, one should be aware of a very big catch here vis-avis FBT on Stock Options. Though FBT on ESOPs/Stock Options is abolished, through a proposed amendment to Section 17(2) of the Income tax Act, the difference between the fair market value of the shares allotted on exercising of the option and the actual value/price at which these shares are allotted, shall be treated as a perquisite in the hands of the employee.

This is a bombshell for employees of companies who have been allotted stock options as, now, they would be required to pay income tax as compared to the earlier requirement of the employer-companies having to pay FBT. Hence, after the Budget, instead of the employer paying FBT, the employee will now pay income tax.

3. In a highly retrograde move, the Government has now proposed to treat sweat equity on par with ESOPs, for purposes of levy of income tax on the differential value (between the fair market value and the value at which the sweat equity shares are actually allotted). There is little logic in this move which would act as a big negative factor for the private companies and especially the IT companies. which have found the sweat equity route to be a good alternative for attracting talent. Perhaps, in one stroke of the pen, the FM has managed to deliver a death blow to the sweat equity scheme, which many of us believed, was anexcellent mode for private companies and especially knowledge based companies, to attract and retain talent.

4. Central Excise Duty/Counterveiling Duty has been abolished on Packaged/Canned software to the extent of value / consideration paid or payable for the right to use such packaged/canned software. One is not able to understand the intent behind this so called benefit, as most transactions related to packaged/canned software happens thro' the licensing route. To my knowledge, packaged/canned software players who provide software licenses do not pay central excise duty, in any case, as no clearance of manufactured goods is involved. What was expected was a clarification that the definition of 'Information Technology Software Services' to mean that 'right to use software' which is already subjected to the levy of sales tax/VAT would not again get taxed as a taxable service, in terms of Clause (vi) of Section 65(105)(zzzze) of the Finance Act, 1994. As is known, as per said Section, acquiring the right to use information technology software supplied electronically' continues to be a taxable service and would get levied service tax. It is disappointing to see that the Central Government continued to be totally confused about the software industry, if this new Notification No. 22/2009-ST dated July 6, 2009 is any indication. The Software Sector, even after this Budget, would continue to pay service tax and VAT on sale/transfer of software licenses, which seems very unfair.

5. While surcharge has been abolished for individuals, corporates would continue to pay surcharge and education cesses. The overall effective corporate income tax rate would continue to be at 33.99%. It would be misnomer to state that the corporate tax rates have been left untouched. The increase of MAT by 50% is a big dampener.

6. There has been a wide spread expectation that the FM would announce simplified procedures for refund of service tax for services exporters. Nothing of that sort has happened. Except for some cosmetic changes in the refund scheme for exporters of goods (remember…. it is for exporters of goods and not exporters of services), there is absolutely nothing to address the woes of services exporters in general and software exporters in particular vis-a-vis their refund claims. Of course, the Notification No. 41/2007 has now been replaced by Notification 17/2009 which apparently talks of simplified procedures and here again, this new Notification is only for exporters of goods. It would seem that the Government is yet to wake up to the fact services exporters in general and software exporters in particular are just not getting refunds from the Department and this Budget would seem to lost a good opportunity to address refund related issues.

7. There are no provisions in the Budget regarding the SEZ scheme. Hence, software exporters would continue to be covered by the existing provisions in Section 10AA of the Income tax Act, as per which, companies which re-structure their operations would not be entitled to the tax exemption. Consequently, STPI units shifting to the SEZ scheme, cannot avail of the tax exemption.

8. Changes in the TDS rates for corporates, proposed to take effect from October 1, 2009 are given below (reproduced from the Budget Memorandum)

Nature of Payment (194-I) (w.e.f. 1-10-2009)Rent Existing Rate Proposed rate*
a. rent of plant, machinery or equipment 10 % 2 %

b. rent of land, building or furniture to an individual and Hindu undivided family 15 % 10 %

c. rent of land, building or furniture to a per son other than an individual or Hindu undivided family 20 % 10 % ** The rate of TDS will be 20 per cent in all cases, if PAN is not quoted by the deductee w.e.f. 1.04.2010* Under the existing provisions of section 194C of the Income-tax Act, TDS at the rate of 2% is deducted on payment for a contract. However, in the case of a sub-contract, TDS is deducted at the rate of 1%. Further, in the case of payment for an advertising contract, TDS is required to be deducted at the rate of 1%. In order to reduce the scope for disputes regarding classification of contract as sub contract, it is proposed to specify the same rate of TDS for payments to both contractors as well as sub-contractors. To rationalise the TDS rates and to remove multiple classifications it is also proposed to provide same rate of TDS in the case of payment for advertising contracts. To avoid hardship to small contractors/sub-contractors most of whom are organized as individuals/HUFs, it is proposed to prescribe following rates of TDS:
(a) 1% where payment for a contract are to individuals/HUF

(b) 2% where payment for a contract are to any other entity.

Nature of Payment (194-C) (w.e.f. 1-10- 2009)Contractor Existing Rate Proposed rate*
a. Individual/HUF contractor 2 % 1 %

b. Other than individual/HUF contractor 2 % 2 %

c. Individual/HUF sub-contractor 1 % 1 %

d. Other than individual/HUF sub-contractor 1 % 2 %

e. Individual/HUF contractor/sub-contractor for advertising 1 % 1 %

f. Other than individual/HUF contractor/ sub-contractor for advertising 1 % 2 %

g. Sub-contractor in transport business 1 % nil*

h. Contractor in transport business 2 % nil*

** The nil rate will be applicable if the transporter quotes his PAN. If PAN is not quoted the rate will be 1% for an individual/HUF transporter and 2% for other transporters upto 31.3.2010.*

***** The rate of TDS will be 20 per cent in all cases, if PAN is not quoted by the deductee w.e.f. 1.04.2010***

Further some of the rates of TDS specified for resident taxpayers have been reduced and converged to 10 per cent. In order to ease the computation of TDS, it is proposed to remove surcharge and cess on tax deducted on non-salary payments made to resident taxpayers.