FM should re-introduce tax holiday under STPI scheme – Feb 24, 2012

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IT's Budget time. Expectations from the IT sector are running high. I've tried to cover the major expectations from this important Sector.

FM should extend the tax holiday provisions

The exporters operating as 100% Export Oriented Units in general and the IT industry in particular, were hugely disappointed when the FM refused to extend the tax holiday contained in Sections 10A and 10B of the Income tax Act, 1961, while presenting last year's Union Budget. With the next Budget round the corner, it is perhaps time to rekindle the hopeson the re-introduction of the tax holiday as also to get the SEZ units off from the coverage of MAT.

Firstly … is there a justification for the re-introduction of tax holiday, this time around? The reasons for the re-introduction of the tax holiday for 100% Export Oriented Units including STP Units is stronger than ever before. If there is one sector which India can hope to play a noticeable role in the global arena, it's the Information Technology sector. India has been faring rather poorly on the export front even in respect of traditional sectors like textiles and garments. It has been reported recently that while much smaller countries like Bangladesh and Sri Lanka have been posting highly impressive growth rates in garment exports, India has been lagging behind. The only silver lining comes from the IT sector. There is no denying the fact that the tax holiday contained in Sections 10A and 10B of the Income Tax Act, 1961, which have been in vogue for over 10 years now, has played a vital part in helping India's IT exports grow, over the years. The tax holiday has really helped the small and medium companies in the IT sector, most of which are export centric. Though the tax benefits for exports have been in vogue from the early 1980s, the tax holiday provisions really came into prominence in 2000-01, which Mr Yashwant Sinha, the then FM extended the 10 year holiday to all units being newly set up.

That, a significant portion of India's overall exports happens thro' the 100% EOU scheme is well known. The tax holiday has been a great bonanza for the IT industry, which has been the scheme's largest beneficiary. The scheme has been especially good for the small and medium IT exporters, as aforesaid, who have been able to plough back the excess cash and grow their business. Though the actual benefit of the tax holiday scheme has been diluted due to the introduction of Minimum Alternate Tax ('MAT') on STP Units with effect from FY 2007-08, the fact that the difference between the MAT and the tax liability is still available for future set off still makes the tax holiday still attractive, considering the fact that, many companies which were set up in the mid-2000s are yet to complete the 10 year period.

With Europe, the second largest destination for India's IT exports going thro' a major crisis and with US trying to bring in curbs aimed at restricting services imports from India, in direct and indirect ways, it is imperative that India's IT exporters who have served the country well over the last decade, are given a helping hand by the FM. The Government would do well to appreciate the fact that the STP scheme is a very unique one under which, even a small room can be used for exporting IT services. While I am not advocating a case for the IT industry to enjoy tax holiday for a period exceeding 10 years, the FM could think of extending the extant provisions which would enable the STP units to enjoy the tax exemption for the remaining years contained in the overall 10 year period.

SEZ Units should continue to be exempted from MAT and DDT

The FM became quite unpopular, while presenting the Budget last time, when he brought the SEZ Units under the MAT scheme and withdrew the exemption in respect of payment of Dividend Distribution tax by SEZ Units. The most unfortunate part was to extend these provisions to existing SEZ Units. Many of foreign investors see this as a complete breach of the commitments given by the Government as contained in the SEZ Act and this could be a classic case of 'promissory estoppel' by the State.

In fact, it would seem that the Government has virtually killed the SEZ scheme by imposing MAT and withdrawing the benefit of exemption of DDT on SEZ Units. There are already reports that SEZ Developers are opting out of the Scheme given the fact that, there are not many takers for the SEZ scheme now.

One would expect the FM roll back the levy of MAT on SEZ Units which could go a long way in ensuring that this scheme does not die.

Tax holiday under SEZ scheme should be extended to STP Units shifting to the SEZ scheme

If the FM takes steps to re-invigorate the SEZ scheme, the next issue for our discussion would be the process of enabling the existing IT units to shift to the SEZ scheme. Apart from commercial issues like availability of the space, the higher rentals, the fact that SEZs are located far outside the cities, etc., STP units shifting to the SEZ scheme have to overcome the impact of the tax provisions which state that the SEZ Units cannotbe formed by the splitting up, or the reconstruction, of a business already inexistence or by the transfer to a new business, of machinery or plant previously usedfor any purpose. It may be recalled that these provisions had been originally incorporated in the Income tax Act in the 1980s in the form of Sections such as 80-J, 80-I, etc., so to ensure that, units which did not invest in new plant and machinery did not get tax benefits. But, the fact remains that these provisions were largely relevant to the capital goods intensive manufacturing industry. In fact, the very concept of 'plant and machinery' which is applicable to the manufacturing industry is largely irrelevant to the IT industry. It is very unfortunate that the Government has not differentiated between a knowledge intensive industry like IT, from the manufacturing industry and as a consequence, the negative provisions mentioned in the other Sections have also found their way into the Sections governing the tax holiday for the IT Units (10A, 10B, 10AA, etc).

A lot of confusion is now prevailing on the continuity of availability of tax holiday for the STP units shifting to the SEZ scheme. The Commerce Ministry's No. 70 covered by F.No.12/4/2010-SEZ dated November 9, 2010 on the availability of tax holiday for units shifting from the STPI scheme to the SEZ scheme has further complicated issues. Why on earth should the Commerce Ministry be allowed to issue instructions on the availability of tax holiday, which, I presume, is the Finance Ministry's prerogative?

Before parting …

Most IT Units would want to exit the STPI scheme, if the tax holiday is not available. Most Units are waiting for the forthcoming Budget for taking the final call. Should the FM refuse to extend the tax holiday, most of these Units would want to exit the STPI scheme.

One would wonder as to what the Government would do with the massive infrastructure that has been created in most cities, to house the offices of the Software Technology Parks of India. In Bangalore, we have one of the finest multi storeyed offices for the STPI located in Electronics City, which would put any large MNC into shame, in terms of its location, interiors, modular furniture, etc.

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