



**PRE-BUDGET MEMORANDUM
2011-12**

About IAMAI:

The Internet & Mobile Association of India ([IAMAI] www.iamai.in) is a not-for-profit industry body registered under the Societies Act, 1896. Its mandate is to expand and enhance the online and mobile value added services sectors. IAMAI is dedicated to presenting a unified voice of the businesses it represents to the government, investors, consumers and other stakeholders. The association addresses the issues, concerns and challenges of the Internet and Mobile economy and takes a leading role in its development. The association's activities include promoting the inherent strengths of the digital economy, evaluating and recommending standards and practices to the industry, conducting research, creating platforms for its members, communicating on behalf of the industry and creating an enabling business environment for the industry. Founded in January 2004 by leading portals in India, IAMAI is the only specialized industry body in India representing the interests of online and mobile value added services industry.

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Introduction :

a) Potential of Internet

Since its inception in 2004, IAMAI, a small and nascent industry body, has been advocating to the government, public and private sectors about the need for creating an environment which helps adoption and use of Internet and data services in the country. Towards this IAMAI has been specifically persistent with government departments directly linked to the promotion of Internet and use of data irrespective of the nature of connectivity and gadgets used.

IAMAI was motivated in this by the collective belief of the industry that adoption of Internet and widespread used of data would be marginally beneficial to the so called well-off sections of the society, but its impact would be disproportionately high to those sections which are comparatively poor and backward. It is our belief that the biggest beneficiaries of the Internet and data revolution would be rural India and poorer India - urban India and well-to-do Indians already have multiple ways of communicating, accessing and using data and information and transacting.

We believe in the potential of the Internet to bring about unprecedented social changes and it is with this positive social impact in mind that the association has been advocating a planned and collective push for Internet adoption by government departments, regulators, planners and the industry. Of course, being pragmatists, we also believe that widespread Internet and data use would also help the nascent industry grow. It was only recently that our advocacy has found very strong and well-articulated voice in the highest authorities of the country: Her Excellency, The President of India, in her inaugural speech at the joint session of the Parliament on 4 June 2009 said, “The rural telecommunication target will be set at reaching 40% rural teledensity in the next five years and... expanding broadband coverage to connect every panchayat to a broadband network in three years. The scheme for Common Service Centres or e-kiosks will be suitably repositioned to be a network of panchayat-level Bharat Nirman Common Service Centres to provide government services to citizens in rural areas.”

The Honorable Prime Minister of India said at the inauguration of 'National Education Day' Celebrations, on November 11, 2009, “I am also very happy to note that a National Mission on Education through ICT has been launched in February 2009

with an outlay of about Rs. 5000 crore. This will provide Internet connectivity to about 20,000 colleges and educational institutions and will be a major harbinger of use of modern technology in the field of education”.

The Honourable Minister for HRD Shri Kapil Sibal in his address at the Conference of Vice-Chancellors & Executive Heads of Universities on 28 November 2008 said, “Just a few years ago, we could not have imagined a university without classrooms or a library without books. Nor could we have imagined a university existing 10,000 miles away from its students. Yet all of this is true today. I believe this is so as the traditional campus-based models of higher education are becoming outside the reach in terms of costs and time of millions of aspirants. As a result there are today over 10,000 institutions offering online education and training and several million students are taking at least one instruction course online.”

The need for connectivity and data use is now clearly understood and lucidly articulated. However, the big questions like “how to make Internet ubiquitous? How to promote the use of data?” still remains somewhat vague.

In the private sector IAMAI has taken the lead on this and has had the privilege of submitting to the Department of Information Technology a comprehensive paper on some of the steps that needed to be taken by the government in order to make Internet accessible and data use more widespread.

We also believe that some fiscal incentives to the consumers and industry would be a critical step towards a more widespread adoption and use of Internet and data. Since 1991 the stated aim and practice of the government has been to deregulate, de-license and adopt open competition. But a closer look at the three sectors that have succeeded most in these intervening years tell a different story. The three sectors that have done well and have contributed to the prosperity and development of the country have been IT & IT enabled Services, Telecom and Infrastructure. In all three, the intervention of the government in form of tax incentives, consumer price regulation and shared cost respectively has been the key driver. The common thread has been fiscal incentive to propel the industry to a take off stage.

In case of Internet/connectivity and data adoption, too, some form or the other of fiscal incentives would be required to take the industry and users to a take off stage. It is with this belief that we submit the following fiscal proposals to the Government of India.

b) Potential of Mobile Value Added Services

In the last 10 years a new industry has grown literally out of thin air. As a subsidiary to the mobile communications revolution; data, content and services on the mobile phone has arisen as a separate and distinct industry in the last decade.

Outside its own circle very little is known about the functioning and the potential of this industry. We feel it is not correct to view this industry or to equate it with spam smses or unsolicited calls alone. The industry has the potential to make significant contribution to the mobile revolution, to the building of India brand in knowledge industries and to ushering in a genuine information disintermediation for Indians.

At present the industry is unequally divided into two parts. One that is operated through the operators or on-deck services and the other which is operated independent of the operators or off-deck services. Most of the companies offer both types of services. Given the current market structure, the on-deck services are the dominant form. However, off deck services are growing rapidly and are expected to become the dominant form in the next two to three years. The growth of off-deck services, it is expected, will encourage the flowering of innovative services and led to a real boom in the industry.

At present, the industry is in the unorganised sector and although informally recognised by the telecom regulator, is not a recognized industry since no licensing or even registration is required with DoT or TRAI.

India's current share of mobile VAS to the overall telecom revenues remain at the lower end (9% share of telecom revenues), even compared to other emerging markets such as Malaysia and Indonesia (30%). This is due to the lack of a support for start ups and entrepreneurs to focus on product, service and device innovation to facilitate the development of a self-sustaining mobile VAS ecosystem in India. The mobile VAS industry in India has significant growth potential for exporting software and services to international markets, as well as contributing to the development of local telecoms market, especially with the introduction of next generation 3G and 4G access technologies.

Following are some of the proposed initiatives that can help foster innovation among software and application developers, allow access to growth capital as well as enable development of a scalable business case for all participants in the mobile VAS ecosystem in India. A majority of these issues can be addressed by suitable policy initiatives and direct & indirect tax benefits.

Part One: Direct Taxes

1. Preferential corporate tax treatment for the high technology Internet and Mobile Value Added Services sectors

Issue:

The best case study of tax incentive helping a fledgling industry grow and reach global proportion with thereby making India a knowledge superpower is the IT and IT enabled service industry. It is generally accepted that the industry would not have reached the stage where it is today but for exemption of Income Tax under sections 10 (A).

Today Internet and Mobile Value Added Services services is what IT and ITeS used to be 10 years back. The Internet technologies is an emerging sector where India has an opportunity to take the lead; they are in a position to create global companies such as Amazon, Google and eBay; they are operating in India helping Indians with their services and making Indians efficient and productive. These sectors have however, never so far been either recognised or given any fiscal benefits. An emerging sector/s requires fiscal and tax benefits to achieve its full potential. What the government did for 15 years for the IT Services sector, without that key support, India would not have seen giants like Infosys and Wipro emerge.

Recommendation :

It is our recommendation that the following organizations be exempt from Income Tax for five years under section 10(A) of Income Tax Act:

- service providers on Internet and mobile;
- companies providing Internet and broadband connectivity
- mobile content providers
- Mobile Value Added Services platform, technology and solutions providers, and

- transaction providers on the Internet and mobile devices

Modern day IT and software is increasingly being defined by online technology providers and an exemption for five years will provide an opportunity to create in India global companies. The revenue loss to the exchequer would be more than made up by the overall social and economic contribution of these companies as has been clearly seen in the case of software and services.

2. Tax Exemptions for long-term Scientific Research and Development

Issue:

The Government of India had earlier granted tax shelter to companies dedicating themselves to the cause of long-term scientific research and development under section 80IB (8A). This benefit was enjoyed by many technology companies. However, this benefit was terminated in 2007 at time when Internet companies had not yet started significant scientific research and development.

However, in the last two years, the Internet services and Mobile Value Added Services companies have started undertaking cutting edge scientific research to provide better services to the Indian users. It is also well known that technology research at present comprise primarily research related to Internet access and services.

Recommendation :

- In order to encourage investments in research relating to Internet and Mobile Value Added Services services, the provision of granting 100% deduction under section 80IB (8A) should be extended up to 31 March 2015.

3. Product Development, Bandwidth Charges and Software License Expenses to be Treated as Revenue Expenditure:

Issue :

Internet Services and Mobile Value Added Services companies invest highly in people and technology.

This is due to the inherent nature of the industry as well as due to the fast changing technology scenario. The government however, disallows such spending as “expenses” treating them as items of long enduring nature.

Recommendations :

- A separate guideline may be issued bringing costs of product development, bandwidth charges and software licenses as revenue expenditure.
- 100% deduction may be allowed in these items in the year that these expenses are incurred.

4. Abolish MAT:

Issue :

Most of the Internet service and Mobile Value Added Services companies are operating at huge losses mainly on account of low product monetization and due to the fact that most of the technical expenditure are treated as capital expenditure. As such these companies are currently covered under MAT at the rate of 18% on their book profit.

Recommendation :

- It is suggested that MAT be abolished for high technology companies especially in the Internet and Mobile Value Added Services sectors.
- This will help companies manage their cash flows better.

5. Fiscal Benefits for Broadband Penetration:

Issue :

The Telecom Regulatory Authority of India in its recommendations on increasing the penetration of broadband had strongly recommended some fiscal measures that would help the internet users and by implications encourage the adoption of internet and broadband by more and more people. TRAI recommendations on Broadband dated 29 April 2004 had 3-pronged approach to the fiscal policies, viz:

- Encouraging the availability of low cost access devices through depreciation, donation and recycling of used Pcs.
- Decreasing to the level of duties on mobile phones the current overall levels of duties for imported items used in broadband networks, and equalizing duties on inputs and domestically manufactured goods with those that are imported.
- Providing the appropriate tax structure to enable faster growth, without the Government having to forego significant revenue.

TRAI Recommendation :

The specific fiscal recommendations in Chapter 5 of the TRAI Recommendations inter alia were:

- Consideration should be given to allowing 100% depreciation in first year for PCs and broadband Customer Premise Equipment (CPE) including modems and routers. (Source TRAI recommendation: 5.3.6)
- Profits that accrue to web hosting enterprises based in India should be partially exempt from the income tax by at least 50% for the next 5 years. (Source TRAI recommendation: 5.5.2)
- The Government of India should also recommend to all State Governments to waive sales tax on goods and services that are transacted through electronic mode (e-commerce) for the next 5 years up to limits to be prescribed by the Government. This recommendation should be then followed with legislation to ensure execution by the State Governments. (Source TRAI recommendation: 5.5.7)
- A similar recommendation or legislation should also go from the Government of India to the State Governments to waive Entertainment Tax, currently approximately 30% in certain states, levied on broadband subscriptions and entertainment services, if they are provided through a broadband or internet platform. This recommendation should be then followed with legislation to ensure execution by the State Governments. (Source TRAI recommendation: 5.5.8)
- All corporations, whether public or private, should be allowed to give a Rs. 6,000 per annum allowance to employees for broadband services access at home. This allowance should be removed from taxable income for the corporation. The same facility should be extended to self-employed professionals so that they may also reap the benefits of broadband services. (Source TRAI recommendation: 5.5.9)

6. Maintaining preferential tax treatment for long-term capital gains for VCFs

Issue :

Internet and Mobile Value Added Services Industry unlike any other industry does not get any kind of financial support from any of the financial institutions. Venture Capital is the only way for them to raise funds and VC investments are critical for nurturing and growing the Indian Internet Industry.

This industry will not get benefitted if Long Term capital gains tax is made the same as short term tax, as a result there will be no incentive for VCs to invest in India, and their money will flow into Israel, Eastern Europe and UK.

Recommendation :

- We would request the Finance Ministry to maintain preferential tax treatment for long-term Capital gains for the Venture Capitalists in the absence of which Indian companies will be starved of the start up capital they need to grow and innovate.

Part Two: Indirect Taxes

1. Ensuring Growth of Internet Services: 5 year Moratorium on Service Tax :

a) On Online Advertising

Issue :

SMEs are the backbone of our domestic as well as international commerce, and Internet is the only medium available to them to access domestic as well as international markets. The additional impact of service tax will have an adverse impact on them. The online industry too is very nascent and it accounts for only 400 odd crores annually. The service tax at this stage of development will hamper the growth of the industry.

Recommendation :

- Moratorium for a 5 year period on Service Tax will allow this nascent industry to grow in size and stabilize and be in a position to accept additional tax responsibilities.

It will also help our SMEs grow and aspire to access new segments of consumers in the domestic as well as international markets.

b) On Online Services

Issue :

Online classifieds industry has been covered under the service tax since 16 July 2001 [under section 65(72)[zh] of service tax notification] and subsequently [under section 65(75)[zh] vide Finance Bill 2008 w.e.f 16 May 2008] Online services have, therefore, been one of the earliest industries to be covered by service tax. It is estimated that under section 65(72) [zh]

online classified industry alone pays a service tax to the tune Rs 60 crores annually which is directly collected from the users by the service providers and submitted to the government. After paying service tax for the last eight years, the online service industry is of the view that a 5 year moratorium should be provided to the industry in Union Budget 2010/2011. The reasons for this suggestion are given under:

1. Online service industry has been the driver of internet penetration and use in India. Since 2000, it is the online service industry such as naukri.com, shaadi.com, timesjobs.com, bharatmatrimony.com, magicbricks.com, which has taught the nation the use and the usefulness of internet. However, even before classified companies attained any scale and size, their services were brought under the ambit of Service Tax; despite being an infant industry, we have never enjoyed the freedom to grow under a benign tax regime.
2. Post the slowdown of 2008-09 it is the online services industry which is once again taking the lead in drawing users back to the internet and also in the general revival of the digital medium. Many smaller and region specific online classified sites have once again set themselves up and are providing useful local and national level services and in many cases in local languages. It may be noted in this context that the entire online classified [part of the online services industry] has been incubated and managed by mainstream media companies such as The Times of India, Hindustan Times, Malayala Manorama, India Today, etc, who have specifically invested considerable resources in this and the overall internet space.
3. Contrary to popular view, the online services industry does not cater only to large corporate or to urban affluent sections. The main base of the online classified industry for example is tiny and micro industries run by individuals, job-seekers, people in smaller towns seeking a

better prospect for themselves, retired soldiers etc. There is, therefore, a very large “social” element to the online services industry.

4. With its crucial social angle, the multiplier effect of even a single online services site for example, in terms of generating business, creating MSME businesses & agencies, employment & livelihood is very significant. For example, the four largest online recruitment sites create better job opportunities for 60 million people. Similarly, four top online general classified sites create opportunities for over 100 million small businesses and self-employed professionals like masons, job contractors, mechanics, plumbers, drivers, etc.
5. It may also be noted that job search is the highest activity conducted on the internet in India, and is a key source of job opportunities in the metros for rural & urban youth.
6. Online services sites, therefore, disproportionately help people who need to be involved, people who need to be included, people who matter.

To reiterate, online classifieds are:

- a) drivers of internet penetration
- b) drivers of adoption
- c) are the main tools for marketing for tiny and small players
- d) have a social role
- e) are the biggest examples of multiplier effect on internet

Recommendation :

For these reasons, they should be given a 5 year moratorium on service tax under section 65 (72) [zh]

c) On Internet Café

Issue :

Internet Café /Cyber café mainly serve those who do not have their own computers and/or cannot afford a regular service at their home, office, shop or institution. Service tax increases the cost of access for such people who are otherwise, economically challenged anyway. According to the recent research, about 30% Internet users in India access from cyber café alone. Going forward, the upcoming 100,000 Common Service Centres being set up by the Government would also be impacted by way of service tax.

Recommendation :

- Cyber café be exempted from Service Tax for at least 5 years. However, the cyber café itself would continue to pay service tax payable to the respective Internet Service Provider for the Internet Connectivity.



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