

Pre-Budget Memorandum 2007/08

1. Direct Taxes

a) Income from Web-Hosting:

Issue

- Currently, many large enterprises prefer to host their websites abroad - some due to legacy reasons but mostly due to higher costs of doing so in India
- Web-hosting is essentially an export substitution service

Impact

- Since Indian service providers need to pay for the full circuit, if the sites are hosted abroad the overall cost goes up resulting in higher tariffs for the end-user than what would have been possible otherwise. In Korea, Japan & China less than 25% traffic goes abroad while in India more than 75% traffic goes abroad.
- This also increases the foreign exchange outflow.

Recommendations

- All income from web-hosting services should be deemed as export income.
- India should be promoted as the location of choice for web hosting.

2. Indirect Taxes:

a) Service Tax on Online Information and Database Services:

Issue:

- The term “computer network service” as defined under Section 65(75) of the Act is extracted as “on-line information and data base access or retrieval” means providing data or information, retrievable or otherwise, to a customer, in electronic form through a computer network.”
- “Computer Network” has the meaning assigned to it in clause (j) of sub-section (1) of section 2 of the Information Technology Act, 2000 and means the inter connection of one or more computer through-(i) the use of satellite, terrestrial line or other communication media; and (ii) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained.
- In connection with Computer Network Service , Section 65(105) (zh) defines the taxable service as:(105) “taxable service” means any service provided or to be provided,(zh) to a customer, by a commercial concern, in relation to on-line information and database access or retrieval or both in electronic form through computer network, in any manner.
- CBEC vide Circular No. B.II/1/2000-TRU, dated 9th July 2001 has clarified the following in regard to levy of service tax under the head of ‘computer network services’:-

- e-commerce transactions will not ordinarily be covered under the Service Tax net under this heading.
 - Internet Service Providers and **online database providers are covered for the levy**
- The non-levy of Service Tax on e-commerce transaction is on the basis that websites do not charge the surfers for information on sale of goods or services offered by them. However, if such information itself is sold then Service Tax will be levied.

Impact:

- Online “database” and information providers form the backbone of the internet economy in India
- There are no large internet and online companies in India. Most of the mid and smaller companies who provide useful services connecting up people with people and people with opportunities and information on the net for small subscriptions have been impacted by it
- The bulk of the internet users use the services of such service providers and the service tax adversely impacts the end-users
- The total amount of transaction on these sites currently is no more than 300 crores and the amount of service tax collected is not in commensurate with the adverse impact it has on the users

Recommendations:

- **A moratorium on Service Tax on online database and information services for 5 years**
- **This will allow the nascent internet economy to grow and attain some scale and be capable of providing better and newer content which will in turn drive the use of internet in India**

b) Service Tax on Online Advertising

Issue:

- Section 65 defines taxable services and various terms used in relation to taxable services. Section 66 is the charging section and provides for levy of service tax on taxable services. These two sections have been amended in the Finance Act, 2006 and these amendments came into effect from 1.5.2006. For details refer to notification No.15/2006-Service Tax dated 25th April, 2006.
- These amendments have brought online advertisements under the vortex of the Service Tax. {Sale of space or time for advertisement, other than in print media; [sub-clause (zzzm)]}

Impact:

- Online advertisement is done by small and medium sized companies who want to take advantage of the internet and reach out to not only the Indian market but the global market
- Most of these advertisers do not have the financial strength to advertise on other expensive media like the broadcasting or print to access the local market and but for

internet they will not be able to access the international market [advertising on foreign newspapers, TV and radio would be financially unthinkable for them].

- 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 advertisement industry too is very nascent and it accounts for only 230 odd crores annually. Service tax collected from this segment is not commensurate with the efforts and cost of collection. Also, the service tax at this stage of development will hamper the growth of the industry.

Recommendations:

- **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.**

c) Service Tax on Credit card, debit card, charge card or other payment card related services

Issue

- Section 65 defines taxable services and various terms used in relation to taxable services. Section 66 is the charging section and provides for levy of service tax on taxable services. These two sections have been amended in the Finance Act, 2006 and these amendments came into effect from 1.5.2006. For details refer to notification No.15/2006-Service Tax dated 25th April, 2006.
- These amendments have brought online payments under the vortex of the Service Tax. {Credit card, debit card, charge card or other payment card related services. [sub-clause (zzzw)]}

Impact

- The Indian credit cards industry is still in a relatively nascent stage when compared to economies of other developing countries. Only 1.4 per cent of Indians currently own a credit card. This is in sharp contrast to countries such as the United Arab Emirates and Kuwait where 63 per cent and 50 per cent of respondents, respectively, own a credit card. In South Korea, there are 400 million credit cards issued to about 100 million South Koreans and effectively this has brought the parallel economy in that country to naught.
- The usage of credit cards by Indians is also much lower than their Asian counterparts. Seventy-two per cent of Indians use their credit cards 1-2 times (or less) a month, while 23 per cent of Indians use their cards between 3-5 times and the remaining 5 per cent use cards 6 times or more every month. In the UAE, 31 per cent of cardholders use their cards more than 10 times during a month, while only 15 per cent use their cards 1-2 times (or less).
- Merchant discount rate, interchange, FX mark-up, etc are now explicitly under the service tax net, thereby increasing the end costs of products to the customers paying

through credit cards. Even if the customer pays through his Net Banking account, the service tax is applicable. Also the Credit Card associations namely MasterCard and Visa have a different interchange rate of offline transactions and online transactions. While the interchange rate for offline transaction is significantly less than 1% of the order amount, the interchange rate for online MasterCard transactions is 1.66% and for Visa is 1.44% plus 0.2% for international transactions. The interchange rate charge by these credit card companies goes even higher if the cards used are corporate cards or platinum cards.

- When these rates are added to the new Service Tax rates, the cost of products and services sold online goes significantly higher than those sold offline. This seriously harms the nascent e-commerce industry in our country.

Recommendations

- **To encourage the nascent e-commerce industry in the country and help it grow the removal of Service Tax on Online Internet transactions done through Credit cards, Debit Cards and Net Banking transactions may be considered.**

d) Service Tax on Mobile Value Added Services:

Issue

- Currently, Service Tax is not applicable on MVAS services since there is no specific entry in the Service Tax Act to cover MVAS services.
- Operators do charge Service Tax when they provide MVAS services to their subscribers because they are covered by specific entry in the Service tax Act. MVAS players are providing services to operators and operators in turn have locus-standi with end users. Therefore, there is already Service Tax levied on end user prices.

Impact

- There is lack of clarity on VAT/ST versus Service Tax on Mobile Value Added Services

Recommendations

- **All MVAS services should be categorised as telecom services and included within the ambit of service tax. This would put an end to the debate whether telecom services are goods or services.**
- **Secondly, MVAS companies should be given exemption from Service Tax since there is no revenue loss to exchequer as on end user price the government is being paid a service tax by the telecom operators who are billing the customers for MVAS services. Levying Service Tax on MVAS players would amount to duplication of efforts.**

e) Service Tax on Internet Café :

Issue

- Service Tax was applied on Internet Café (zzf) in 2003

Impact

- 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.

- According to the recent research, about 39% 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.

Recommendations

- **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**

Part D

3. Miscellaneous

a) E-Commerce Export of Jewellery

Issue

Current Procedure of Jewellery e-Commerce Exports:

- No Separate law for jewellery export shipment of single pieces
- IEC code is mandatory, VAT registration is required (buying locally), and GJEPC membership is desired
- Seller has to appraise the jewellery piece through a Govt. authorized appraiser
- Submit the piece to the customs at the International Post office, where the customs officer values it based on the appraisal and charges a fee
- Time taken for appraisal and custom valuation is 8 to 10 days and the average cost of documentation and appraisal comes to about 1000- 1200 for a \$100-\$150 item
- A clean shipping bill (no export incentives) is normally filed under which less than \$25000 value of goods can be exported through courier/post
Insurance is mandatory on 20% of value of item, but the premium is very high (about 10% of the insured value)
- Courier Companies do not take jewellery and precious items as there are restrictions for them, but if they take then the cost of shipping is quite high

Impact

- The cost becomes exorbitant for shipping, and the process is quite time consuming that hits the seller margin and ability to compete with sellers from other countries
- There are other 'expenses' incurred at the customs and overheads like hiring agents who get this job done
- Sellers sometimes resort to declaring their precious jewellery as artificial/ costume jewellery , as it is freely exportable through courier, which is not only a risk if the package is lost or stolen but also is flouting the regulations

Recommendations

- An amendment in the Jewellery exports policy should include 'Single Item' shipments through eCommerce
- Jewellery to be taken off the restricted list (at least for ecommerce 'single piece' shipments) and couriers should be allowed to carry jewellery freely
- The documentation process to be simplified (at least like other product categories), whereby only an invoice needs to be submitted with a seller declaration
- 'Single piece' shipment for precious jewellery/gemstones should be allowed without appraisal for a value of up to \$1500 per shipment

b) Entertainment Tax on Internet & Broadband Access:

Issue

- Many state governments have been imposing entertainment tax on Internet & Broadband service, thus killing them in infancy.

Impact

- Load of entertainment tax on Internet & broadband services can play havoc considering that the rate of this tax itself is astronomically high in most states.

Recommendations

- **All state governments may be directed not to impose entertainment tax on Internet & broadband services.**

Annexure -A

Relevant Excerpts from the Broadband Policy 2004

“The department is conscious of the fact that Broadband services can reach the urban and rural consumers only if services are offered at affordable and easy terms. Department of Telecommunications will work out a package in consultation with Ministry of Finance and related Departments as well as concerned service providers to achieve this.”

Salient Recommendations of TRAI regarding Fiscal Policy

5.3.6 Consideration should be given to allowing 100% depreciation in first year for PC's and broadband Customer Premise Equipment (CPE) including modems and routers.

5.3.7 Consideration should also be given for tax benefits to organizations on the value of PC's, as defined by the Government through a value schedule, that they donate to schools run by the government / local bodies, and charitable organizations.

5.3.8 Finally, consideration should also be given to removing the anti-dumping duty for recycled PC's imported into India.

5.4.3 Duties levied on inputs (parts, components and spares) and finished products used in providing broadband and internet services should be reduced to levels equivalent to that for mobile phones.

5.4.4 Additionally, the central excise duty levied on these items should be reduced to the extent the customs duties are proposed to be reduced on a pro-rata basis, and in line with duties on imported finished goods.

5.5.2 Profits that accrue to such web hosting enterprises should be partially exempted from the income tax by at least 50% for the next 5 years .

5.5.5 ISP's should be exempted from the payment of service tax, which is 8% of the value of the service provided, for the next 5 years. This exemption will reduce immediately the cost of purchasing such services by 8% to the customer.

5.5.6 The service tax levied on the services that are used by ISP's in the delivery of their service to internet and broadband customers should also be exempted.

5.5.7 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.

5.5.8 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.

5.5.9 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.