Software Product Industry Representations for Budget Feb 2017

#	ISSUE	CURRENT ISSUE	SUGGESTION
1.	Harmonisation of tax policy for listed and unlisted equity instruments	There is a disparity in the tax rates applicable for capital gains on sale of listed securities (12 months) vis-à-vis sale of unlisted shares (24 months) and other unlisted securities (36 months).	The Finance Act, 2016 has reduced holding period for unlisted shares from 36 months to 24 months. However, to ensure consistency and remove differing time thresholds for different securities, the request is to make the period of holding as 12 months for all securities similar to listed shares. . Hence the following change should be considered: [*The third proviso to section 2(42A) of the Income-tax Act, 1961 should be deleted.* *Further, in the first proviso to section 2(42A) of the Income-tax Act, 1961, in place of the expression "a security (other than a unit) listed in a recognized stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of an equity oriented fund or a zero coupon bond", the expression "shares, securities, bonds, debentures, units or any other like instrument" should be substituted.*]
2.	Dividends from overseas subsidiaries taxed again in India	Dividend received from overseas subsidiaries is taxed in India as income in the hands of the company. Also, while the rate of tax on such dividends for certain companies is 15% (as against 30%), the same exemption is not provided to limited-liability partnerships and individuals.	Section 115BBD of the Income Tax Act, 1961 to be amended as under: '115BBD. Tax on certain dividends received from foreign companies.—(1) Where the total income of an assessee includes any income by

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			way of dividends declared, distributed or paid by a specified foreign company, the income-tax payable shall be the aggregate of— (a) the amount of income-tax calculated on the income by way of such dividends, at the rate of fifteen per cent; and (b) the amount of income-tax with which the assessee would have been chargeable had its total income been reduced by the aforesaid income by way of dividends. (2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing its income by way of dividends referred to in sub-section (1). (3) In this section,— (i) "dividends" shall have the same meaning as is given to "dividend" in clause (22) of section 2 but shall not include sub-clause (e) thereof; (ii) "specified foreign company" means a foreign company in which the assesse holds twenty-six per cent or more in nominal value of the equity share capital of the company.’

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3.	TDS on Sales of Software	Payments for use of copyright versus copyrighted article has given rise to considerable litigation in the past. Introduction of Explanation 4 to Section 9(1)(vi) of the Income Tax Act, 1961 has further created uncertainty because as per that provision, income from sale of software could be treated as royalty which is not in line with the international practice and is only akin to sale of a product not for use of any intellectual property rights in the software.	Income from Software sales should not be classified as Royalty income and **Software Products** should be treated as "Goods". Accordingly, the following explanation i.e. Explanation 4 to section 9(1)(vi) of the Income-tax Act, 1961 should be deleted: [*Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.*]
4.	Taxation of convertible instruments to ;be clarified	Tax position on convertible instruments is unclear. Whilst there is specific provision in relation to conversion of debentures, taxation on conversion of preference shares as well 'ESOP swap' remains unclear. This becomes particularly important in case of technology companies, as investors are used to invest in such companies by way of various types of convertible instruments. Further, most of the employees in technology companies are incentivized by ESOPs. At the time of acquisition such companies by another company, employees swap their ESOPs in such companies with ESOPs in the acquirer company. In a way, employees do not have an option but to swap ESOPs. However, this forced swap is	The government should re-confirm its Instruction No. F.No. 12/1/64-IT(AI) dated 12th May 1964 as per which (i) conversion of one type of share into another type of share does not amount to transfer, and (ii) cost of acquisition of the share acquired upon conversion is the cost of acquisition of the original instrument. Further the following language to be added in Rule 8AA of the Income-tax Rules, 1962: [*In the case of a capital asset, being a share of a company, which becomes the property of the assessee by way of conversion of shares of one kind into another kind of shares of that company, there*

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		considered to be a taxable event, and the employees are required to pay tax pursuant to the same. Accordingly, in the absence of clarity on taxation of convertible instruments such as preference shares and ESOP swap in India, Indian technology companies prefer to move abroad so that it is easier for them to issue and convert convertible instruments to their investors and swap ESOPs of their employees. In addition, Companies which go for IPO cannot continue to have convertible instruments, and all such instruments are mandatorily required to be converted into equity shares. The current law is unclear on whether the equity shares received upon conversion would be considered to be held from the date the convertible instrument was held (for the purposes of determining whether the same are long term or short term assets for levy of capital gains upon sale of such shares post the IPO). This results in uncertainty and acts as a hindrance to all companies with convertible instruments in their decision for an IPO.	*shall be included the period for which the shares so converted were held by the assessee prior to the conversion.'’*]
5.	Abolish SOFTEX forms for Software Product	Software product are nothing but "digital goods". The only difference they have with physical goods is "intangibility". Hence, they are sold on MRP basis and usually a brand name is very important. Given these 2 elements of MRP and Brand they do not require any valuation to be done when exporting. SOFTX certification only adds	The SOFTEX forms should be abolished for Software Products. A minimal process could be taken care by Authorized dealers in foreign remittance accounting to report Software product exports.

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		to friction in Software product trade. As a reform measure	
6.	Taxation on Indirect Transfers	While the valuation rules have been prescribed, there is no clarity as to whether standalone or consolidated financials of the target foreign company/ entity and the underlying Indian company/ entity should be considered. This should be clarified as the general valuation norms consider consolidated financials, however, in absence of express language, one may want to consider only the standalone financials which leaves scope for interpretation issues and uncertainty.	Thus, it should be specifically provided in the valuation rules that "*For the purposes of these rules, consolidated financial statements of the respective entities should be considered".* · In Explanation 5 to Section 9(1)(i) of the Income Tax Act, the scope of expression "interest" in a foreign company should be clarified. Since the provision covers entities other than companies as well, it should mean interest in a partnership firm etc.; and not other instruments or rights in a company such as convertible debt, stock options or P- notes in a fund context, where the holders of these instruments merely have economic interest and not ownership interest or voting rights or management/ control rights. This was pointed out by the Expert Committee as well. Thus, it is requested that Explanation 5 be amended as "For the removal of doubts, it is hereby clarified that an asset or capital asset being *any share in a company* or interest in an entity other than a company, registered or incorporated outside India….".

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7.	Digital Goods and Services Confusion.	A clear treatment and definition of Digital (intangible) "Goods" and "Services" is very important to have clear tax treatment in a "Digital Economy".	One rate of tax in GST will not solve this problem, as detailed provisions and the value chain of provisioning, use or consumption of goods and services will keep causing problems.
8.	Taxing the B2C sales of Foreign online sales	Unlike the Indian Software product companies, the foreign software products companies are not subject to VAT or Service tax on online sales of their software products when sold in B2C model. Indian companies need to be provided the level playing field. Europe has already started this.	In India we can implement this using technology. Or Conversely exempt all B2C online sales of Software from all indirect tax.