Telecommunications

Union Budget 2016

Post-Budget sectoral point of view

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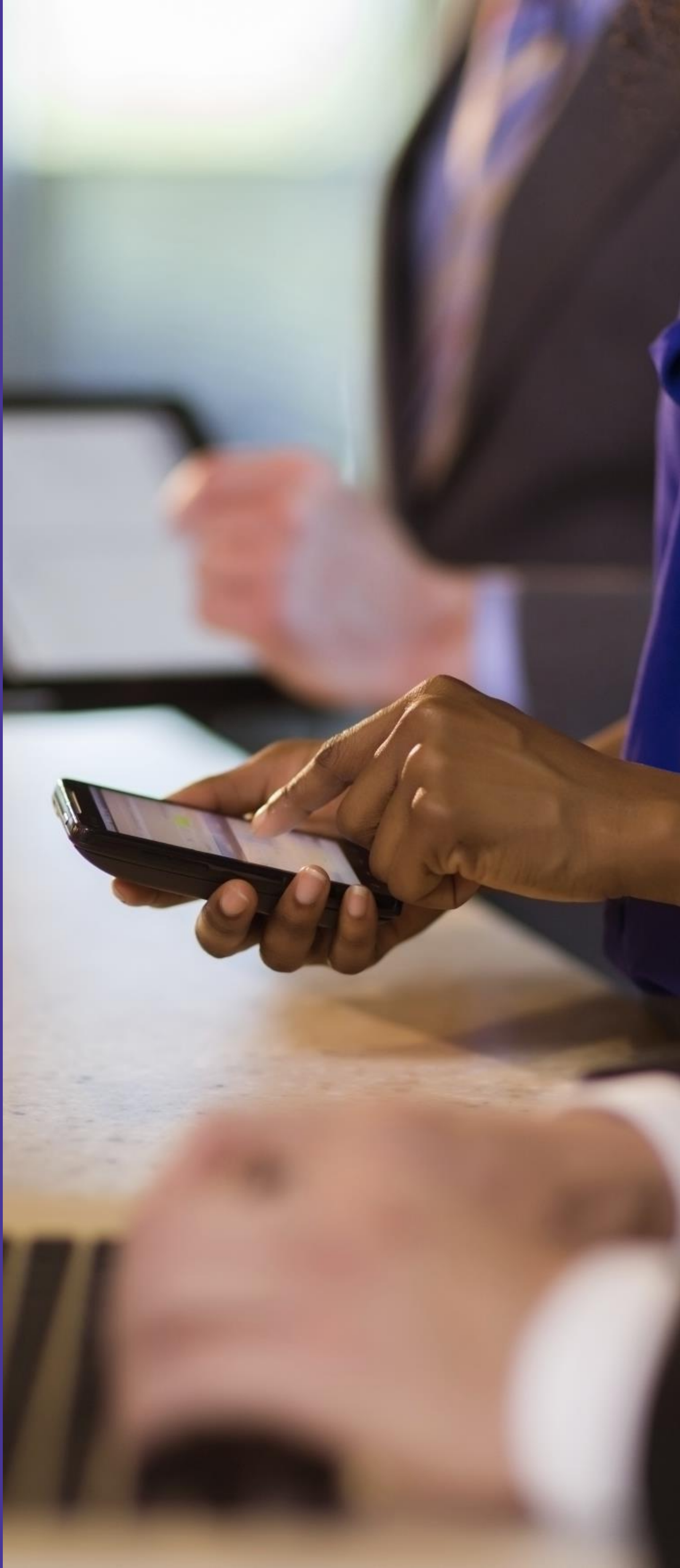


Context

Where we are

India is currently the second largest telecommunications market in terms of subscribers. There are more than one billion mobile subscriptions and 325 million internet users as at the end of December 2015[1]. Rural markets provide a huge opportunity for growth with tele-density approximately 50 per cent[1]. The internet and broadband market has the potential to double with devices becoming cheaper and internet speeds becoming faster in the years to come[2].

Increasing data consumption propelled by the roll-out of high speed services (3G and 4G), rising use of internet-enabled mobile apps, media services such as mobile video, music, games, social network, etc. is further driving subscriber growth.

The government's focus on 'Digital India', 'Make in India' and the vast fibre optic backbone implementation would allow various stakeholders in the telecom ecosystem to be part of growth story and boost domestic telecom equipment manufacturing.[2]

Key issues/challenges

The telecommunications sector is facing several challenges on multiple fronts:

- High cost of spectrum and capital investments
- Complex tax structures resulting in multiple tax levies
- Debt and costs of funding
- Uncertainty over Over-the-Top (OTT) players and implications of net neutrality on revenue models
- Difficulties in Capital Expenditure (CAPEX) deployment including Right of Way (RoW) norms.

Government's stance

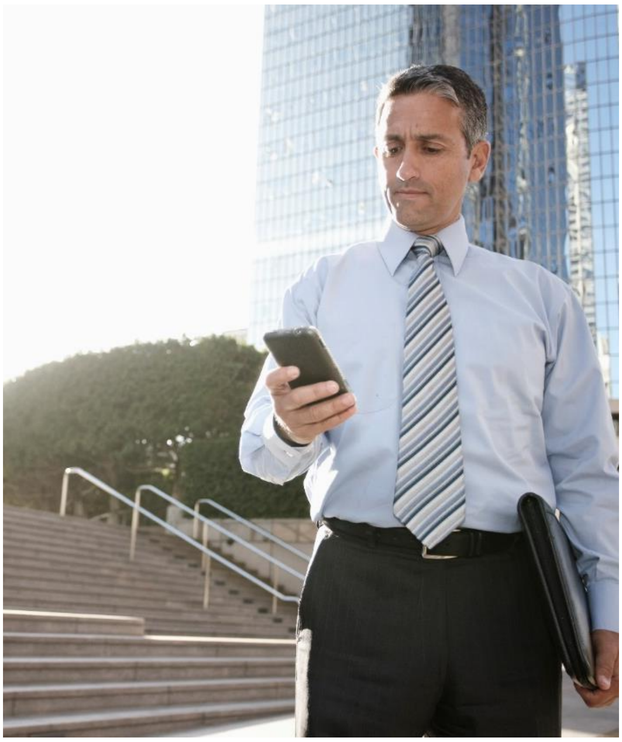
Overall, the government is committed to 'Digital India' as a significant economic growth driver and a method of citizen empowerment. Some of the key points that the government is committed to are:

- Enabling the 'common-man' to receive quality communication services at a reasonable price
- Sustainable growth for the industry
- Reducing dependence on imports for telecommunication equipment
- Leveraging the power of connectivity for e-governance and services to citizens
- Promoting a culture of entrepreneurship based on telecom services
- Reducing ambiguities in policies.

Expectations (policy/fiscal/tax)

Clarity on various policies is the top expectation of the telecom sector's wish list from this year's Budget. Some of the other major expectations were:

- Rationalisation and simplification of the current tax structure
- Steps to boost manufacturing of telecom products domestically in India
- Reversal of the 2012 retroactive amendments to income tax laws together with a mechanism to resolve current cases
- Structural reforms to control spending and achieve fiscal deficit targets in line with fiscal consolidation roadmap.



1. TRAI Press release No 15/2016 – Telecom Subscription Data as on 31 December 2015
2. KPMG in India analysis, 2016

Key policies/fiscal and tax proposals

Our point of view

As was the case last year, the Budget did not include any big-ticket announcements. The agenda largely focussed on the welfare and development of the agricultural sector and rural community. There has been a strong thrust on infrastructure development and leveraging Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) as a means to create jobs. The key priorities outlined in the Budget, i.e. macro-economic stability and fiscal prudence, growth from the domestic sector and policy changes to benefit the common man augurs well for the Indian economy as a whole and the Telecom sector.

Key announcements in the Union Budget that might have both a direct and indirect impact on the sector include:

Policy

AADHAR – a move towards cashless transactions

- The statutory backing to the AADHAR platform for benefits transfer is a positive for telecom operators who are well positioned to utilise their digital infrastructure, mobile money and payment bank license capabilities to promote cashless transactions.

Digital Literacy Mission Scheme

- The scheme to cover an additional six crore households in rural India within the next three years with Digital Literacy related initiatives can help telecom operators expand their internet penetration and drive data consumption.

Massive Open Online Courses (MOOCs)

- Entrepreneurship Education and Training through MOOCs can encourage telecom operators to collaborate with educational institutes to offer MOOCs over their networks and increase data consumption.

Rural electrification

- 100 per cent village electrification by May 2018 can help promote telecom services throughout the country.

Direct tax

Amortisation of spectrum fees under section 35ABA

- Spectrum payments can now be amortised over the period for which the spectrum remains in force. However, this provision has a prospective effect. So ambiguity remains on spectrum payments that have been already been capitalised in the books of telecom companies as intangible assets depreciable over four to five years.

Alternate dispute resolution

- A scheme to settle the vast number of cases under the Income Tax Act, 1961 ('the Act') and Wealth Tax Act with respect to matters pending at first appellate levels, High Court, Supreme Court or any arbitration (including those arising on account of retrospective amendments) as on 29 February 2016. The amounts in question include tax, interest and penalty determined under the aforementioned Acts
- If a tax payer avails of the Alternate Dispute Resolution scheme, the appeal shall stand withdrawn and the matter cannot be re-opened. Further, the tax payer shall get immunity from prosecution with respect to such matters
- In case of tax disputes arising on account of retrospective amendments only the disputed tax needs to be paid. In all other cases where amounts in question are greater than INR10 Lakh, tax and interest along with a minimum of 25 per cent penalty needs to be paid.

Place of Effective Management (POEM) proposed to be deferred by one year

- POEM to be applicable from 1 April 2016 (AY 2017-18). A mechanism to comply with the provisions of the Act (i.e. computation of income, treatment of unabsorbed depreciation, set off and carry forward of losses, etc.) for foreign companies who becomes residents of India by virtue of POEM still needs to be prescribed. This is a relief for India-based telecom companies with global operations.

Permanent Account Number (PAN) not required for foreign companies

- Provisions of section 206AA of the Act shall not apply to non-resident companies with effect from 1 June 2016, subject to the conditions that need to be prescribed. This may bring much needed relief to Indian telecom operators while dealing with non-resident telecom companies not having a PAN in India.

Lower tax rate for domestic companies engaged in manufacturing

- An option to avail a lower rate of income tax of 25 per cent (compared to the rates applicable for corporates) by newly set up domestic companies engaged in manufacturing has been provided. These companies have to forego incentives (accelerated depreciation, investment allowance, expenditure of scientific research, etc.). This option can provide some relief to the telecom hardware industry.

Base Erosion and Profit Sharing (BEPS) action plan – Country by country report and Master file

- All MNC companies in India that have consolidated group revenues (based on consolidated financial statements) exceeding Euro 750 million or its equivalent in local currency have to follow a three-tiered reporting structure, maintaining a:
  - Master file containing standardised information relevant for all Multinational Enterprise (MNE) group members

— Local file referring specifically to material transactions of the local taxpayer; and

— Country-by-country report containing certain information relating to the global allocation of the MNE's income and taxes paid, together with certain indicators of the location of economic activity within the MNE group.

This is likely to provide an additional reporting and compliance burden on Indian telecom companies – especially those Companies that have large investments from Global Telecom players.

Processing of returns under section 143(1D)

- Currently, the processing of returns and issuance of refunds have been required to be held back under the law for cases where scrutiny proceedings have been initiated. This has led to refunds getting delayed by three to four years. An amendment is now proposed to allow tax authorities to process tax returns and allow issuance of refunds before the completion of scrutiny proceedings. This is a welcome move as it will help improve improving cash flow of tax payers.

Indirect tax

Service tax:

Taxability of spectrum

- Assignments of spectrum on a ‘right to use’ basis by the government and subsequent transfers, have been declared as ‘service’. The Budget speech states that this is being done to make it clear that such activity is a ‘service’ liable to service tax, and not ‘sale’ of intangible goods
- A special mechanism has been prescribed for availing CENVAT Credit of service tax paid for assignment of the right to use a natural resource. CENVAT Credit shall be available on a staggered basis, depending on the period for which rights have been assigned
- This may result in working capital being blocked for telecom companies, as the quantum of input service tax could be substantial while the apportionment of credit shall take place over the period of rights assigned
- In cases where such rights are further assigned, the balance CENVAT credit shall be available in the financial year of sale – however, the credit shall be restricted to the service tax payable on consideration for such further assignment.

Krishi Kalyan Cess

- Levy of Krishi Kalyan Cess at 0.5 per cent would increase effective service tax rate to15 per cent, which needs to be considered in the pricing of services.

Customs and excise duty:

- Basic Customs Duty (BCD) exemption on specific telecommunication equipment such as soft switches, VoIP equipment, OTN/PTN products, MIMO/LTE products, etc. has been withdrawn
- Customs and excise duty rate structures on certain products have been realigned to provide a boost to domestic manufacturing of several products, including products in the electronics/telecom sector
- Certain specific duty changes, providing a thrust to the Make in India initiative, on the telecom sector, are discussed below:

  — Charger/adapters, batteries, wired handsets/ speakers used in the manufacture of mobile handsets

    - Customs duty exemption on the aforementioned products have been withdrawn. Further, excise duty exemption has also been withdrawn, and Excise duty of 2 per cent (without CENVAT Credit) or 12.5 per cent (with CENVAT Credit) has been prescribed
    - Customs duty and excise duty exemption has been granted to parts and sub parts used in the manufacture of the aforementioned goods

  — Routers, broadband modem, set top boxes for TV or for gaining access to internet, digital or network video recorder, CCTV or IP cameras

    - Instead of an earlier 12.5 per cent excise duty rate, option has now been provided to the manufacturers, to pay Excise duty of 4 per cent (without CENVAT Credit) or 12.5 per cent (with CENVAT Credit)
    - Customs duty and excise duty exemption has been granted to parts and sub parts used in the manufacture of the aforementioned goods.

Other indirect tax aspects:

- The Budget speech reiterates the government’s endeavor to ensure the passage of the Constitutional Amendment Bill in the Parliament for introduction of Goods and Services Tax (GST)
- Various proposals have been introduced to move towards a non-adversarial indirect tax regime.

  — Interest rate for delay in payment of duties/taxes reduced

  — Simplification of procedural requirements and relaxation in compliances

  — Thrust to create a taxpayer friendly environment and reduce litigation

  — Liberalisation of CENVAT credit provisions

Unfinished agenda

What remains

Direct tax

- Whether tax should be deducted at source on margins of SIM cards and vouchers distributors is a long standing dispute. In a highly competitive market, where margins are generally around four to five per cent[1], ten per cent deduction at source would be tough on many small and medium sized traders dealing in such cards and vouchers. Considering the government's initiatives on implementing GST, where these distributors and retailers would be incentivised to come into the tax base, the government could have considered to not qualify the margins as 'commission' subject to withholding at the rate of 10 per cent
- The Finance Act 2012 classified domestic as well as cross-border telecommunication services as 'royalty' which leads to withholding tax at 10 per cent. Revenues against provision of telecommunication services is in the nature of a standard service. It does not arise out of an actual possession or control of rights, properties or information which is essential to its classification for the purpose of royalty. The government could have considered withdrawal of this amendment.

Indirect tax

- The industry awaits a clear roadmap on implementation of GST, along with a mechanism for consultation between government and industry players, on typical telecom industry related issues, which should be considered under the GST regime.

What is expected going forward

The telecom operators are likely to go through structural and operational changes. Though high debt, complex merger and acquisition norms, and exit barriers may create hurdles, the visibility on the tax treatment of spectrum can help telecom operators to move towards consolidation.

Various private and public players have formed strategic alliances to leverage 'Make in India' to promote domestic manufacturing and connect the population through 'Digital India'. Telecom operators have been working towards the launch of their payment bank operations. With statutory backing and use of the Aadhar platform for benefits transfer, it is likely that the telecom operators will look to monetise this new revenue stream.

Additionally, rural electrification and the digital literacy mission can help drive internet penetration and increase data consumption.

1. KPMG in India analysis, 2016

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