



# THE IT & ITES SECTOR AN OVERVIEW

BDO IN INDIA  
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Information Technology (IT) and Information Technology-enabled Services (IT & ITeS) is one of the fast-growing service sectors in India. The sector contributes to about 43% of India's export revenue and comprises of 7% to 8% of India's GDP and is expected to contribute about 10% by 2025. It is one of the key contributors to employment in the service sector and attracts large investments from abroad. The IT & ITeS sector in India is regulated through different tax and regulatory laws which include Corporate tax, FEMA, Foreign Trade Policy, the SEZ law and GST.

While the IT & ITeS sector in India has faced several challenges over the years due to its evolution coupled with a dependency on global economies, the Indian regulators have constantly addressed these challenges to enable ease of doing business.

## IT & ITeS SEGMENTS

The IT & ITeS sector can be bifurcated broadly into software and hardware categories, wherein the software part of the sector dominates its hardware counterpart. However, the Indian Government through its Make in India initiative has set goals to make India a key global player in the IT hardware sector and has introduced incentive schemes for the manufacture of semiconductors, laptops, tablets, all-in-one computers, and servers. The classification of services or goods covered under the sector are:



### SOFTWARE

- IT Consulting, Research & Development, Engineering Services, Software Development and Software Testing
- Business Process Outsourcing (BPO)/ Knowledge Process Outsourcing (KPO)/ Centre of Excellence (COE)
- Packaged Software/ Software as a Service (SaaS)



### HARDWARE

- Laptops, Computers, Tablets, Servers, Semiconductors, Motherboards, CPUs, RAMs and all components related to Computers and Data Processing Units

Apart from the above, the entities operating in the IT & ITeS sector can be classified based on the nature of operations and the location from which such entities operate:

- Export-oriented Units (EOU)
- Domestic Tariff Area (DTA) units involved in the export of services to their affiliates located outside of India
- DTA units serving the Indian market
- Special Economic Zone (SEZ) units

## KEY TAX CHALLENGES

The IT & ITeS sector continues to face several challenges from tax perspective resulting in certain implications and impediments that may impact the sector's business operations. We have highlighted key challenges from a tax perspective as prevalent in the industry:

### ▶ GST Refund Claims & Working Capital

GST paid on the procurements of the sector can be claimed back as a refund from tax authorities upon proving that the services or goods are exported outside India. However, the delay in processing refund claims or producing requisite documentation to the tax authorities is a challenge to the sector, which leads to blockage of working capital by way of refunds receivables. Additionally, the refund value is restricted to ineligible procurements and capital goods procurements for specified categories of taxpayers, which further leads to working capital blockage.

### ▶ Deemed Supply Provisions under GST

The GST law has introduced a taxing mechanism wherein transactions between related parties are subjected to tax even when such transactions are carried out without consideration or contractual terms. The entities tend to overlook these transactions for determination of taxability as there is no specific entry passed in the books, which leads to tax demands during audits by GST authorities. A list of such transactions is covered below:

- Employees of overseas affiliates or parent entities rendering management or any other services to the Indian entity without consideration
- Software licensed by affiliates or overseas parent entities used by the Indian entity to perform its activities without consideration
- Any other services procured centrally by the affiliates for use of Indian operations without any cross charge of costs back to the Indian entity.

### ▶ Realisation of Foreign Exchange (FE) within 12 months

An entity not realising foreign exchange towards its export of services within the stipulated time of 12 months is issued with a demand of GST at 18% towards the unrealised value of foreign exchange. The entity needs to take appropriate measures to obtain a time extension if it expects a delay in the realisation of consideration regarding its exports. As per the Finance Act, 2023, SEZ units that want to claim tax benefits on the export of goods or services will have to mandatorily realise the export proceeds in convertible foreign exchange within six months from the end of the financial year. Further, as per the extant FEMA provisions, it is obligatory on the part of the exporter to realise the export proceeds within nine months from the date of export. Accordingly, the exporter of services will have to ensure that all the above timelines are adhered.

### ▶ Disputes on the classification of services of the IT-BPM sector as 'Intermediary'

The GST law considers the place of supply for determining the taxability of any transaction. In the case of the export of services, the place of supply is generally outside India and hence the transactions are zero-rated and given the benefit

of exports. However, services in marketing and facilitating supply are classified as 'Intermediary services', where services rendered by an Indian entity to its overseas customers are denied the benefit of exports due to the place of supply provisions. The provisions governing 'Intermediary services' are not clear and have led to tax authorities interpreting genuine export transactions as intermediary and demanding tax on exports.

▶ **Secondment of Employees**

The Hon'ble Supreme Court of India, in the case of *M/s Northern Operating System Pvt. Ltd.*, had held that the arrangement of overseas employees being deputed to an Indian entity will be treated as 'manpower' services (not treating such persons as employees of Indian entity) rendered from the affiliates/ overseas entity to the Indian entity and hence the transaction will be subjected to tax under reverse charge in the hands of the Indian entity. The ruling is subsequently followed in multiple other judgments leading to entities operating in the sector reviewing their tax positions and contractual terms with overseas affiliates for the deputation of resources in India.

Further, cross border movement of employees is also a vexing issue from a direct tax perspective whereby the entities operating in the sector generally face queries from tax authorities. Queries usually pertain to reimbursement of salary cross-charged to group companies, creation of a permanent establishment of the foreign entities seconding their employees to their group company in India, Withholding Tax (WHT) implication on the salary paid to the seconded employees by the company in India, etc.

▶ **Disputes on the classification of Software as Goods vs Services**

The question of whether the software is classified as a good or service is a debate carried forward to the GST law from the erstwhile VAT laws in India. Even though several judicial pronouncements have established principles to determine whether the sale of software qualifies as goods or services, the question still needs to be addressed definitively under the GST law. The classification of software as goods vs services will have implications on the place of supply, time of supply and refund claim-related provisions.

▶ **Reimbursement of Expenses**

Entities operating in the sector tend to classify certain transactions or expenses between their affiliates as reimbursement of expenses. The GST law does not recognise any transaction as mere reimbursement unless such a transaction qualifies the conditions of 'Pure agent'. Entities need to ensure that any payment treated as reimbursement is first subjected to review from a 'Pure agent' perspective before concluding taxability under GST.

Further, the above is closely monitored by the direct tax authorities as to whether the conduct between the parties for the reimbursement of expenses is on a Principal-to-Principal basis or Principal-to-Agent basis.

▶ **Escalated Tax Rates for Fees for Technical Services and Royalties**

With the recent amendment in the Finance Act, domestic tax rates on fees for technical services and royalties earned by a non-resident or a foreign company from India is increased to 20% (plus applicable surcharge and cess). Non-residents or foreign companies would need to undertake beneficial ownership/ substance evaluation and necessary registration/ compliance by obtaining a Permanent Account Number (PAN) and filing a return of income in India to claim the beneficial tax rate as prescribed in the treaty. Further, non-residents representing the countries which do not have a treaty with India may have to shell out more taxes in India due to an increase in the domestic tax rates.

▶ **Significant Economic Presence (SEP)**

SEP has been defined to include transaction in respect of any goods, services or property carried out by a non-resident with any person in India including the provision of download of data or software in India if the aggregate of payments arising from such transaction/s during previous year exceeds given threshold. An activity may constitute SEP irrespective of whether the non-resident service provider has place of business in India or not. Currently, taxpayers from treaty countries can claim exemption SEP as similar provisions are not there in the tax treaty. However, taxpayers of countries with which India does not have a tax treaty may have exposure to SEP. In those circumstances, non-resident entities may be required to comply with the Indian income-tax requirements, i.e., obtaining PAN, opening a bank account, maintenance of books of accounts and getting the same audited in India.

▶ **Overlap between Equalisation Levy, WHT and GST**

Overlapping provisions of WHT under section 194-O of the Income-tax Act, 1961 (IT Act), Equalisation Levy (EL 2.0) and GST on OIDAR services is a key issue. For instance, in case of a transaction where a resident customer avails services from a resident e-commerce participant through a non-resident e-commerce operator, the non-resident e-commerce operator shall be required to collect TCS on the payment for the supply of such services to the resident e-commerce participant under the GST regime. They will undertake WHT on the payment/ payables for the supply of such services to the resident e-commerce participant under section 194-O of the IT Act and pay EL 2.0 on these amounts of the consideration received/ receivable from the customer in India.

▶ **Intra-group transactions/ arrangements from a Transfer Pricing perspective**

With an increase in global competition, multinational enterprises tend to form centralised service centres for provisions of services within the group. Further, such intra-group arrangements, being transactions with related parties, attract transfer pricing provisions whereby it becomes necessary to evaluate whether the cost charged to associated enterprises is at arm's length price or not. Intra-group transactions have caught the interest of tax authorities and are constantly being monitored to evaluate if they result in shifting of the profit base to lower tax jurisdictions.

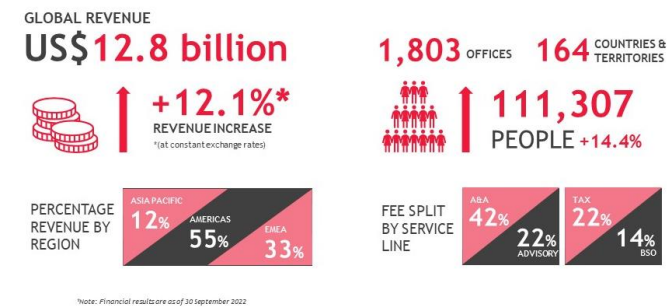
## OUR SERVICES

Backed by global expertise, coupled with years of experience and domain knowledge, our team of tax experts at BDO in India understand the nuances of tax and compliance-related challenges and work to provide solutions to address the challenges faced by the industry on account of evolving tax laws. Our services are designed to provide businesses:

- Assistance in structuring the input tax credit availment, reconciliation and the manner of claiming a refund from the regulatory authorities.
- Assistance in making applications and representation before regulatory authorities to obtain GST refund claims.
- Advisory assistance on a case-to-case basis depending on the operational model to determine one or more of the following -
  - Determining the PE exposure and the resultant tax liability
  - Evaluating transactions to determine the WHT obligations for the service recipients
  - Analysing and determining the transactions which may result in creating a significant economic presence of the foreign entity in India
- Advising about the Indian reporting requirements and documentation to be maintained thereof.
- Assistance in obtaining tax registrations in India.
- Assistance in seeking Advance Ruling/ Advance Pricing Arrangements before the tax authorities.
- Assistance in providing technology-enabled tools, maintaining a tracker of ongoing litigations, assistance in the issuance of Form 15CA/CB and managing Y-o-Y tax positions of the company.
- Undertaking day-to-day compliances for direct & indirect taxes so that the company can focus on core competencies.
- Assistance in structuring/ restructuring business operations to strategise & accommodate any deal arrangements.

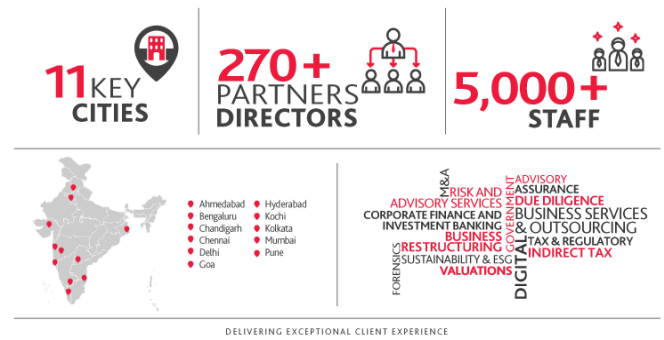
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BDO in India offers Assurance, Tax, Advisory, Business Services & Outsourcing and Digital Services for both domestic and international clients across industries. The team at BDO in India consists of over 5,000 professionals led by more than 270 partners and directors operating out of 16 offices, across 11 key cities.



## CONTACT US

For queries regarding our services, please write to us at [taxadvisory@bdo.in](mailto:taxadvisory@bdo.in)

For any other comments or feedback, kindly write in to [marketing@bdo.in](mailto:marketing@bdo.in)

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