

# White Paper on INFORMATION TECHNOLOGY SECTOR

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## SECTION 1 - INTRODUCTION

### 1.1 Introduction to Ease of Doing Business

The “Ease of doing business” is a World Bank index which is widely used to rank 189 countries for their present business laws and regulation environment every year. The index however does not take into account general conditions like macroeconomic indicators, market proximity, infrastructure etc. Further, “Ease of doing Business” ranking is characterised by the average of 11 sub-indices like starting a business, getting credit, electricity, registering property etc. A higher ranking indicates efficient and simpler regulations for business and strong protection of property rights. This index not only identifies the source of the obstacle for doing business in a country, but also serves as the basis for policymakers to compare the regulatory environment for business across countries and design more compelling regulatory reforms for future.

India is one of the fastest growing economies in the world and has become one of the most attractive investment destination in the world. On analysing “Ease of doing business” index for 2016, we observe that India has moved up its ranking to 130, up by 4 units as compared to the previous year. The improvement in ranking is mainly because of the ongoing reforms and the 2 major drivers are, “Distance to frontier” sub index where India outperformed all the South Asia countries since 2004. The biggest improvement came from “Getting Electricity” sub index where the ranking jumped to 70 in 2016 from 137 in 2015. In order to complement its economic growth, India has to set major reforms to improve “Ease of doing business” ranking and attract more investors.

While Government of India (GOI) is constantly encouraging investments, the Department of Industrial Policy and Promotion (DIPP) is complementing the government's initiative by taking several initiatives to ease doing business in India. The future reforms taken by GOI must ensure that India is on equal footing amongst other countries in terms of flexible, favourable, efficient and transparent business environment.

With this in view, the British High Commission (BHC) has initiated a study called “Breaking Business Barriers” for various sectors in India which focuses on stakeholder engagement and arriving at insights around business barriers. Specific recommendations have been identified for each of these sectors. The main objective of this report is to emphasize on the retail sector and the various barriers faced by businesses. We hope that the findings of this report would help bring the issues of retail sectors to the forefront and also serve as a reference point for the imminent need to pursue reforms in business policies and processes.

### 1.2 Introduction to Breaking Business Barriers

*Centre for Public Policy Research (CPPR)* in association with the *British High Commission (BHC)* has taken up an initiative '**Breaking Business Barriers**' aiming to curtail the regulatory barriers in

setting up, operating and exiting a business in the state of Karnataka, Kerala and Tamil Nadu. The initiative focuses on easing the business in seven sectors - Drugs and Pharmaceuticals, Education, Energy, Information Technology (Hardware & Software), Infrastructure, Retail and Manufacturing.

The initiative intends to enhance the development of a business-friendly environment in these states, by removing the regulatory barriers in doing business. The collaboration with the stakeholders has helped to identify the issues and challenges faced by them in operating the business and work towards finding a solution. In this regard, CPPR organized round table meetings with the Government representatives and business community in order to understand all relevant information regarding policies, taxation regimes, rules and other general information for doing business.

The website *EasyBiz* ([easybizindia.com](http://easybizindia.com)) India is created for the purpose of giving insights into the policy framework in the three states and measure state competitiveness. The website offers an interactive portal for the entrepreneurs to flag the issue faced by them in operating the business and work with one another to resolve the issue. The portal also has a clear process flowchart of the steps involved in starting a business (licenses, NOC, certificates) in the three states.

## SECTION 2- SECTOR OVERVIEW

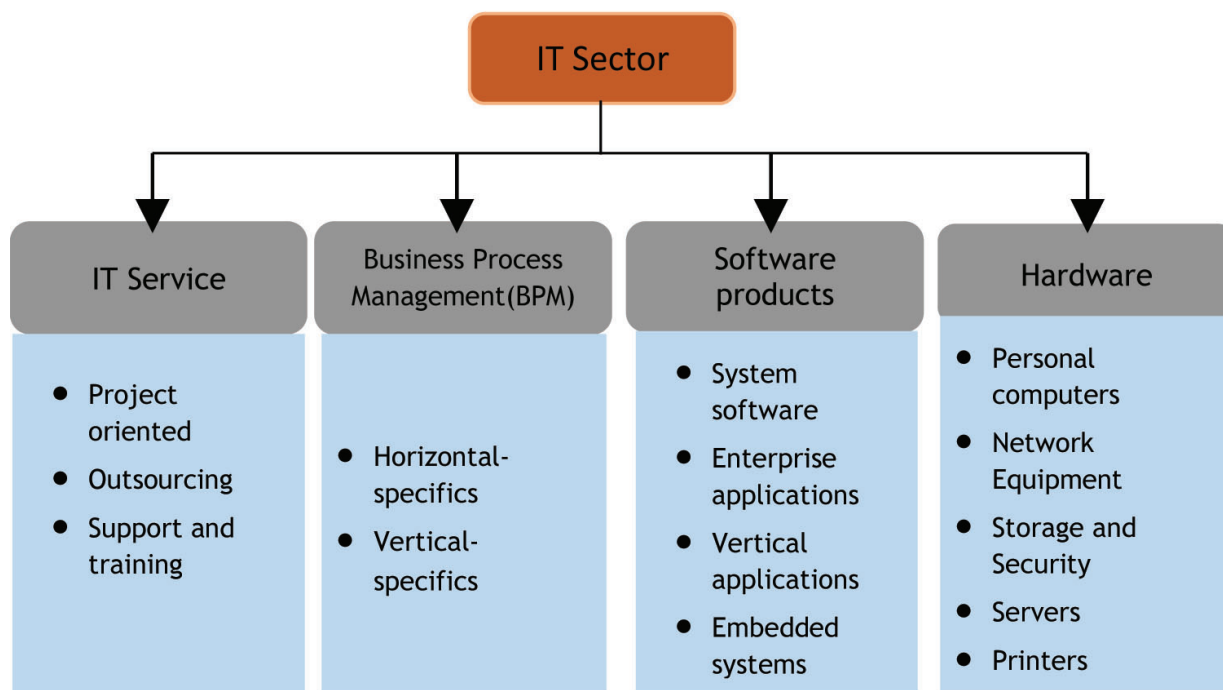
### 2.1 Definition

The Information Technology Association of America has defined information technology as "the study, design, development, application, implementation, support or management of computer-based information systems"(Proctor, 2011). The application of computers and telecommunications equipment to store, retrieve, transmit and manipulate data is known as Information Technology (Daintith, 2009). The term Information Technology was coined by the Harvard Business Review, authors Harold J. Leavitt and Thomas L. Whisler "the new technology does not yet have a single established name. We shall call it information technology (IT)." This was done in order to make a distinction between purpose-built machines designed to perform a limited scope of functions and general-purpose computing machines that could be programmed for various tasks (Techtarget, 2015). In the past two decades information technology has been the major source of growth and employment compared to any other sector.

### 2.2 Information Technology sector in India

According to a report by Federation of Indian Chambers of Commerce and Industry (FICCI) Indian Information Technology (IT) industry has been one of the significant contributor to the growth of the Indian economy, it has also played a key role in putting India in the global map(FICCI,2011). India's information technology sector is broadly classified into four segments: IT Services, BPM, Software and Hardware (NASSCOM).

Figure 1 - Structure of IT Sector



Source: NASSCOM

In the financial year 2015 India's technology and BPM sector (including hardware) has generated a revenues of \$146.5, implying to a growth rate of 23.72 per cent when compared to the revenues generated in the financial year 2014 of \$118 billion. The sector's contribution to India's GDP rose from 1.2 per cent in financial year 1998 to approximately 9.5 per cent in the financial year 2015. IT-BPM sector (including hardware) were estimated to have generated \$98.5 billion in exports during financial year 2015 (IBEF, 2016). Major share of IT export (including hardware) was from IT services accounting to 56.12 per cent followed by Business Process Management (BPM) which accounted to 23.46 per cent in the financial year 2015 (Indian Chamber of Commerce, 2015)

The industry today is India's largest and most diverse private sector employer, with a direct workforce nearing 3.5 million, and affecting over 10 million indirect jobs (NASSCOM, 2015).

The Central government has come up with National Policy on Information Technology, 2012 and National Policy on Electronics, 2012. The policy encourages innovation and R&D in cutting edge technology in order to promote IT sector in the country, and make the country emerge as the global hub and destination for IT.

The National Policy on Information Technology, 2012 suggests the use of technology in social sector initiatives like Education, Health, Rural Development and Financial services. The

Government is also planning to implement the Start up policy with an aim to provide employment and promote entrepreneurship skill(DeitY, 2015).

## 2.3 Overview IT sector in State

The IT sector in all three states of Karnataka, Kerala and Tamil Nadu plays a prominent role in the economic development of the state and it is also one major employment provider in the state. The state governments have also come up with their own policies with the aim of making the state a IT-investment destination of the country. The state policies have taken initiatives to support and invite investment to the state from IT sector. To attract investment all three states has set up investment zones and IT parks where a IT company can be easily set up.

Both Karnataka and Kerala governments have also come up with a startup policy to support and promote startups in the state. The policy aims at bringing a world class startup ecosystem in the state and setting up incubation centre for providing better employment opportunity for the youth.

## 2.4 Investment and FDI

According to data released by Department of Industrial Policy and Promotion (DIPP), many major countries have started investing in Indian IT sector. The computer software and hardware sector in India attracted cumulative Foreign Direct Investment (FDI) inflows worth US \$ 18.17billion between April 2000 and September 2015. Start-ups were expected to receive funding worth US \$ 5 billion by the end of 2015, a 125 percent increase in a year (India in Business, 2015).

In the year 2015 about 554 startups received funding compared to 342 during 2014. Seed and venture capital funds made investments worth \$ 3.4 billion, which is three times the investment made in the year 2014 (IBEF,2016) .

Government has allowed upto 100 per cent Foreign Direct Investment (FDI) for both IT software and hardware sector, subject to all applicable regulations and laws. The 100 per cent FDI is permitted under the automatic route in data processing, software development and computer consultancy services, software supply services, business and management consultancy services, market research services, technical testing and analysis services. FDI of up to 49 per cent is allowed for electronics items for defence under the government approval route, whereas anything above 49 per cent is allowed through the approval of the cabinet committee on security (DeitY, 2015).

## 2.5 Government Initiatives

The Department of Electronics and Information Technology (DeitY) has initiated many promotional programmes to boost to the IT and Electronics Hardware sector. Some of the major initiatives are, creating infrastructure support by setting up of Information Technology Investment Region (ITIRs), also provide R&D expertise and training programmes. The department also provides latest information on industry trends, management models, market and advanced technologies.

## SECTION 3 - WAY FORWARD

The Indian IT industry has been in existence for more than two decades, it is one of the major contributor to Indian growth and employment provider. The Government have taken many initiatives and steps to support entrepreneurs in this sector. But based on our research we were able to identify some of the issues affecting people entering into this sector.

Following are some of the specific issues faced in the IT sector

### 3.1 Entry

#### Issues:

Below are of the issues faced while starting a business in this sector.

- **Requirement of multiple Approvals/Clearances** : For starting an IT company a person has to obtain multiple approval/clearances from different departments. Such as land use permission, approval from electricity, approval from pollution control board, licenses from shops and establishment etc. It was noted during our study that the website of the information technology departments of the three states does not properly mention the different processes and department involved in setting up an IT company.
- **Tax registration** : Before setting up a company one has to register under different tax act both at central and state level and the process of registration is different for different taxes. The registration process is a time consuming process because even though there is one registration for these taxes, it was observed in most cases the entrepreneur has to visit the department with hard copy to complete the registration process. Also once an application for registration is made, the registering authority will conduct a inspection and only after that will provide the registration.

#### Suggested Reforms:

Below are the reforms outlined to address the challenges faced during starting a business in this sector

- The process of approval/clearances and registration should be made through an online portal of the department involved. The portal should provide information regarding the process involved, the documents needed to be submitted. Entrepreneur can upload all the required documents for registration to the online portal of the department and download the approval/clearance directly from the portal instead of going to the department. The portal should also help to track the status of his application and the time period for his application to pass. It will be easier for the entrepreneur if all the approvals/clearances and registrations are properly listed with the timelines along with the fee required in the website of the information technology department.

- The process of registering of the central taxes has been made online, also the registration of state taxes such as VAT and profession tax has been made online. But the registration process has to be made completely online instead of visiting the department. In Tamil Nadu, the time required to get VAT Registration one week, if however the registering authority has not given registration within 30 days of the application and if no notice is issued then the applicant shall be deemed to have been registered.

## 3.2 Operate

### Issues:

Issues faced by an information technology company during operational stage is discussed below

- **Monitoring Issue** : One of the common issue faced by companies existing both inside a IT Park and outside is inspection by various departments such as labour, ESI/PF, tax etc. Many are not aware of the different documents and records to be maintained and produced before the officials. It was noted that in most of the cases the officials coming for the inspection is also not aware of what document they need to check.
- **Renewal of licenses** : the process of renewing a license is a time consuming process. There is no online process for renewing a license or permit, an entrepreneur has to go to the department and produce all related documents to renew the licenses. Most of the time an entrepreneur is not aware of the process and time taken for renewing a license.
- **Bidding for Government Projects** : IT companies are not interested to get involved in government projects related to this sector such as DRDO project, UID projects mainly because of delayed payment. This delay in payment effects more a smaller IT company than a large IT company. In case of most of the technology contracts of government the vendors requires to work as a system integrator (SI) which means they have to not only provide the stware and services, but have o arrange the hardware elements (The Economics Times, 2015) Also a smaller IT company may find it difficult to involve in government project because of complex bidding norms. The bidding process of most of the government projects is based on the annual turnover of the company, many smaller IT companies with lesser annual turnover are finding it difficult to take part in the bidding process.
- **Lack of Quality Testing Facility** : There are no proper product testing facilities, so any companies bring out products into the market without properly testing it.
- **Double Taxation** : For all internet downloads of software and related services such as maintenance contracts, there is a dual levy of both value added tax (AT and service tax as well as



potentially tax deductible at source (DS. Software under the present tax law is liable to be taxed under Service Tax, VAT, Excise Duty, Customs Duty, etc depending on the nature of transaction whether it is sale of 'Goods' or 'Service' or 'Both' The reason for this is Service tax on service goes to the Central Government and VAT on sale of goods goes to State Government, with both the governments being totally exclusive in terms of taxability and revenue sharing.

An amendment made to Section 65 (105), Chapter V of the Finance Act, brought Information Technology (I.T.) Software under the meaning of 'Taxable service.' Consequently, supply of packaged software as well as right to use packaged software licence became subject to both VAT and Service Tax.

Since there is lack of clarity there are many cases when both VAT and Service tax & Excise Duty are applied which leads to cascading effects of taxes which is also known tax on tax or Double Taxation. The present average tax is around 25-35 percent.

- **Human Resource** : There is lack of availability of skilled labour in IT Hardware industry when compared with Software industry. We can't make use of the available manpower as this industry is highly dependent on skilled human resource who could carry out R&D resulting in novation and producing quality products.

#### **Suggested reforms:**

Below are some of the reforms outlined to address the challenges faced during starting a business in this sector.

- The State Assessment Report by DIPP (September 2015) has ranked Jharkhand and Gjarat as the top two states in terms of carrying out inspection, this is because of the introduction of unified inspection, allocating inspectors online, publishing a checklist for inspection. Allocating inspector online is through a method where a random inspector is allocated a random unit for inspection, and after the inspection the inspector have to give a report within 7 working days otherwise he has to give explanation to his superiors. This practice can help in improving the transparency in the process of inspection. If similar mechanism is introduced it will improve the monitoring mechanism.
- The process of renewal of licenses and permits should be made online so that it can reduce the time involved in the renewal processes. Karnataka labour department provides online renewal of shops and commercial establishment thereby causing less disruption to business hours.
- The bidding process for government projects should not focus much on the annual turnover of the company so that small companies and even startups can take part in process. In projects that require both hardware and software expertise, there is no point in clubbing both into same

vendor. A large IT company can do this but it will be difficult for a smaller companies. The government should restcture way in which some tenders are given, so that more than one company can take part and work on the different components of the same project.

- The Government should work with major prayers of this industry or associations in this in coming up a product testing and design facility. This facility can aid a IT company in coming out with quality products after conducting proper testing.
- The issue of double taxation can be resolved if proper clarity is there regarding what type of tax is to be paid by the software company. Karnataka high court came with a ruling that implementation of customized software is a service and cannot be subject to VAT. In this ruling the Karnataka high court held that customized software development services qualify to be services and are not liable to VAT under Karnataka Value Added Tax Act, 2003. The issue of double taxation can be solved if amendment is brought in the Value Added Tax Act that defines the implementation of customized software is a service and cannot be subjected VAT.

Also with the introduction of GST some of the issues related to this can be resolved, since every transaction shall be dealt both by State (SGST) and Central Government (CGST). The proposed GST rates shall be around 18-25 per cent.

- By establishing sill development centres and incubation facilities the lack of skilled employees in IT sector, particularly IT Hardware sector can be changed. Presently the start up policy by both Karnataka and Kerala talks about giving training to students from school itself to improve their skills and encourage innovation from the educational institution itself.

### 3 Exit

#### Issue:

For the easy closure of a business the IT sector does not have a definite exit policy. During the study it was found that the process of closing a business establishment in this sector is a time consuming process this phase involves surrender of licenses to different departments such as registrar of company, labour, electricity etc and inspections from these departments certify the closure.

#### Suggested Reform:

Creating a online portal where the licenses can be surrendered and the certificate of closure should be given by the department within minimum time period.

## SECTION 4- CONCLUSION

Globally India has developed itself as one of the favourite destination for Information Technology. For the past two decades this sector has developed considerably compared to all the other sectors. It has risen as one of the major contributors to the economy and employment provider. But there are still some issues remaining in this sector which impede the growth of this sector. Requirement of many registrations, approvals, monitoring, tax issues, are some of the issues which are still affecting people related to this sector. If these issues are resolved, it will be a great advantage for this sector.

Still now the major contributor for this sector is from the IT software sector but for the sector to advance itself globally it should also focus more on the IT hardware industry also. Future growth of the IT sector can be ensured if everybody related to the sector works together both Government and the stakeholders.

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The Report on “Breaking Business Barriers (BBB)” has been the culmination of the research conducted by Centre for Public Policy Research on theme of 'Ease of Doing Business' in three southern India states namely; Kerala, Karnataka and Tamil Nadu. The project was executed for a year starting from May, 2015.



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