Industrial Manufacturing

Union Budget 2017-18

Post-Budget sectoral point of view

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Setting the context

Where are we

The Indian manufacturing sector, for the last two to three years, has been facing challenges despite the continuous effort of the government to boost manufacturing and generate employment through 'Make in India' and 'Skill India' initiatives, alongwith reforms for improving the ease of doing business. However, the situation is not only linked to the government policies and is also attributed to increased global uncertainty, impacting the manufacturing sector. Further, the subdued demand scenario has kept the domestic and foreign players from making any fresh investments.

The current political development around the globe is creating a scenario of deglobalisation. To create more local employment the governments are urging to bring back jobs both in the manufacturing and services sector. If these measures are pursued by other developed economies, it would have an adverse impact on the manufacturing sector of developing economies such as India.

Demonetisation, a move to curb black money, has also hit the manufacturing sector significantly (although for a short term), mostly Micro, Small and Medium Enterprises (MSMEs), which thrive on cash transactions. One of the positive development, in the recent months, has been the firming up of commodity prices, especially in steel, that has created some hopes for the commodity manufacturing sector.

Key issues/challenges

- **Flat demand:** The slow demand growth, both locally and internationally, is impacting the order inflows. The demonetisation move has further impacted the demand, although for a shorter time

- **Low capacity utilisation:** A subdued business and investment environment is keeping the industrial production at a low and, hence, impacting the capacity utilisation. During the April–November 2016 period, India’s output has shown a meagre growth of 0.4 per cent as compared with 3.8 per cent during the corresponding period of the previous fiscal.

- **Increase in debt burden:** The manufacturing sector is a significant contributor to the non-performing assets (NPAs) of banks in India. As per a report by the Reserve Bank of India (RBI), the manufacturing sector contributes approximately 33 per cent to the total gross NPAs of INR6 lakh crore.

- **No fresh capital investment for capacity creation:** The morale of the private sector continues to be at a low, which in turn is keeping the investments below potential. Capital goods production, an indicator of investment activity, has registered 18.9 per cent de-growth during the April–November 2016 period as compared with 4.9 per cent growth during the corresponding period of the previous year.

Government’s stance

The government has been working towards the implementation of Goods and Services Tax (GST), one of the most significant tax reforms since the country’s independence in 1947. GST, once implemented, is likely to have a number of positive effects on the economy, such as improved ease of doing business, removal of multi-tiered tax structure and making India a uniform market.

However, in the absence of private sector investments, the government has been trying to improve the economic growth by increasing government expenditure. The government has also been continuously working towards boosting business sentiments. Recent initiatives, such as simplifying regulatory
approvals, opening up of Foreign Direct Investment (FDI) landscape in different sectors and continuous focus on improving the country’s infrastructure, have helped in building the sector’s confidence.

**Expectations**

- GST is in the advanced stage of implementation, therefore, there was not much expectations from an indirect tax perspective. The major expectation from the Budget was around the improvement of the business climate by some direct tax reforms, which could drive economic growth
- Increase government spending in infrastructure and rural economy which has a direct impact on various sub-sectors of manufacturing such as steel, cement, engineering goods and construction materials
- Provide more disposable income into the hands of the public which in-turn would increase the demand for different sub-sectors
- Reduce the corporate tax rate to provide more net profit to the companies which in-turn could be used for capital investments
- Although no big bang announcements were expected in indirect tax, however, certain reforms around duties were anticipated by the sector. This includes:
  - Exemption from customs duty on import of Liquefied Natural Gas (LNG)
  - Allow credit of Krishi Kalyan Cess to manufacturers
  - Relief from dual levy of customs duty and service tax on import of design/drawings in soft copy
  - Amendment of the definition of ‘exempted service’ to exclude treasury income, dividend, etc., for CENVAT reversal under Rule 6(3)
  - Safeguard measures to provide a level-playing field to Indian players vis-a-vis imports.

### Key policy proposals

#### Key announcements

**General proposals**

- Total allocation for rural, agricultural and allied sectors for 2017-18 is INR1.87 lakh crore, an increase of 24 per cent as compared with that of previous year
- Plans to invest INR3.96 lakh crore in creating and upgrading the country’s infrastructure
- Allocation of INR1.31 lakh crore as the capital outlay for the Indian railways, an increase of 8.26 per cent as compared with that of in FY17; this includes INR55,000 crore gross budgetary support, which would be provided by the finance ministry
- Plans to build one crore houses for poor; also, affordable houses to be given infrastructure status
- Allocation of INR745 crore under the Modified Special Incentive Package Scheme (M-SIPS) and Electronic Development Fund (EDF) for the electronics manufacturing sector
- Reduction in the income tax rate for individuals earning between INR2.5 lakh and INR5 lakh to 5 per cent from the current rate of 10 per cent
- Plans to build 100 India International Skills Centres across the country.

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*Budget Speech 2017-18, accessed on 1 February 2017*
Key direct tax proposals

- Corporate tax remains unchanged, except for the companies having annual total turnover or gross receipts not exceeding INR50 crores for which the tax rate is reduced to 25 per cent
- Deduction of interest above INR1 crore payable by a company or permanent establishment of a foreign company in India, to a non-resident related party in respect of debt incurred is restricted to 30 per cent of earnings before interest, tax, depreciation and amortisation (EBITDA) of the borrower and balance allowed to be carried forward for eight years. This is in line with the recommendation of Base Erosion and Profit Shifting (BEPS) Action Plan 4 on thin capitalisation
- Time limit for carry forward of Minimum Alternate Tax (MAT) and Alternate Minimum Tax (AMT) credit has been extended from 10 years to 15 years and MAT provisions amended to consider adjustments required pursuant to adoption of Ind AS by corporates
- Lower withholding tax of 5 per cent in respect of interest on money borrowed from foreign source extended for money borrowed until 30 June 2020 (from 30 June 2017) and its benefit also extended to rupee denominated masala bonds issued outside India
- The window for start-ups to claim 100 per cent profit linked deduction provided for any three consecutive years out of the first seven years. Restriction on private companies to carry forward and set-off the prior years’ losses in the year of change in shareholdig relaxed for eligible startup companies in respect of losses of initial seven years provided all the shareholders carrying voting power on the last day of year of loss continue to hold those shares
- Series of measures introduced to discourage generation of black money through cash transactions. These include restriction on deduction of expenditure/ depreciation/ investment linked deduction for cash payments to any person in excess of INR10,000 in a day. Penalty equal to the amount of cash receipt exceeding INR300,000 introduced for any transaction with a person in a day
- Profit-linked deduction for export profits of units in special economic zone (SEZ) restricted to the total income of the taxpayer (and not of the unit) arrived at after making all adjustments under the Income-tax Act 1961 (Act) including set-off of any losses of non-SEZ units.

Merger and acquisition proposals

- Period of holding for Long Term Capital Gains (LTCG) has been reduced to two years from the current of three years, in case of land and/or buildings
- LTCG on transfer of equity shares in a listed company acquired on or after 1 October 2004 to be exempt if the securities transaction tax (STT) has been paid on acquisition of such equity shares or such acquisition has been notified by the central government
- Clarification provided that the reduced rate of tax at 10 per cent on the sale of shares of unlisted companies by non-resident taxpayers is applicable retrospectively from 1 April 2013
- Conversion of preference shares into equity made exempt from the ambit of transfer and any potential capital gains taxation
- Fair Market Value (FMV) (to be prescribed) will be deemed to be the full value of consideration for computing capital gains in the case of transfer of unquoted share at less than FMV
- Taxation at 10 per cent on gross basis for the transfer of carbon credit. Rate to be increased by surcharge and cess
- Assessment timelines rationalised to ensure ease to the taxpayer.

Transfer pricing proposals

- Applicability of domestic transfer pricing now restricted to entities with tax holiday units. The requirement of domestic transfer pricing compliance for non-tax holiday entities making payments to domestic related parties done away with
- Secondary adjustments by way of interest on ‘deemed advance’ introduced. Deemed advance represents transfer pricing adjustment by way of enhancement of income or reduction of deductible
expense for an Indian company (suo moto or otherwise including in advance pricing of agreements (APAs)/ mutual agreement procedures (MAPs)) for which no amounts have been remitted or repatriated back to India respectively.

Key indirect tax proposals

Customs duty/excise duty

- Changes in basic customs duty/excise duty with respect to the following goods:
  - Customs duty on LNG has been reduced to 2.5 per cent from the current of 5 per cent
  - Customs duty on catalyst/resin for use in the manufacture of cast components of wind-operated electricity generator has been reduced to 5 per cent from the current of 10 per cent, while the excise duty has been reduced to nil
  - Solar-tempered glass or solar-tempered anti-reflective coated glass for use in manufacture of solar cells/panels/modules has been exempted from customs duty, while the excise duty has been increased to 6 per cent
- Reduction in basic custom duty to 5 per cent and excise duty to 6 per cent on parts/inputs for use in the manufacture of LED lights or fixtures, including LED lamps and inputs
- Exemption from customs duty and excise duty to micro ATMs as per standards version 1.5.1; fingerprint reader/scanner; iris scanner; miniaturised POS card reader for mPOS (other than mobile phones or tablet computers); parts and components for use in the manufacture of the aforesaid goods
- Basic customs duty reduced to 5 per cent on import of all items of machinery, instruments, etc., required for the initial setting up of fuel cell-based system for generation of power or for demonstration purposes; or the balance of systems operating on bio-gas or bio-methane or by-product hydrogen. Similarly, excise duty has been reduced to 6 per cent until 30 June 2017, subject to specified conditions.

Service tax

- Abolition of R&D cess with effect from 1 April 2017
- One-time upfront development charges/salami payable to State Government Industrial Development Corporation for the grant of long-term lease of an industrial plot, not liable to service tax during the period between 1 June 2007 and 21 September 2016.

Impact

- Increasing focus on rural development, improving country’s infrastructure and increasing investment in the Railways are likely to create demands for different sub-sectors of manufacturing, such as steel, cement, engineering goods and construction materials
- Policy announcements for electronics manufacturing sector are likely to attract fresh capital investments in the sector in the near future
- Most MSME companies are likely to benefit out of tax rate of 25 per cent giving them a competitive advantage and an impetus to make further investments ultimately contributing to the growth agenda
- Tax proposals introduced restricting cash transactions to curb the generation of black money could to an extent impact the growth in short run but should help achieve an inclusive growth in medium to long run due to increased accountability, proper reporting and reduced tax leakages.
Unfinished agenda

What remains

• Some of the important and much awaited measures such as complete abolition of MAT / AMT, reduction in the corporate tax rate across the board or abolition of dividend distribution tax (DDT) for SEZ units did not see any mention in the Budget, delaying the required impetus to backtrack growth in the sector.

• Restoration of incentives at higher rates to encourage companies to invest in research and development and the latest technology to manufacture products of international standards.

• Clarifications on deduction linked to employment generation are required to bring clarity and encourage employment generation in the sector.

• With too many accounting and regulatory reforms to tackle and in order for better preparedness, the industry was looking forward to the deferral of the general anti-avoidance rule (GAAR) and income computation and disclosure standards (ICDS) which did not happen and is likely to overburden the industry with substantial compliance requirements.

What is expected going forward

• The manufacturing sector has been looking forward to the implementation of GST; hence, the sector would expect smooth and timely implementation. Additionally, the sub-sectors would also expect optimum and supportive GST rates, which would help them increase their profitability and drive growth.

• The sector would also expect adequate policy reforms to improve the ease of doing business which in-turn would help achieve the targets of the ‘Make in India’ initiative.

• Since export is a significant revenue contributor to the sector, fiscal incentives to promote exports could help India realise its goal of becoming a manufacturing hub of the world.

• Some significant improvement in infrastructure and simplifying regulatory approvals along with cheap credit should be implemented in order to improve India’s position in terms of the ease of doing business.
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