Transport and Logistics

Union Budget 2016
Post-Budget sectoral point of view

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Context

Where we are

During his 2015-16 Union Budget announcement, the Honourable Finance Minister laid considerable emphasis on infrastructure, with an increased allocation of funds and overall policy initiatives for the sector. In particular, the Budget focused on roadways, Foreign Direct Investment (FDI) in railways, labour reforms, corporatisation of ports and the Public Private Partnership (PPP) model, as key areas for infrastructure development.

As India prepares for a transition to the next level of the logistics growth trajectory, the need of the hour is for the government to bring about the necessary infrastructural changes, and announce regulatory policies and measures to chalk out a roadmap for the logistics sector in the coming years. While it is imperative for the policymakers to accelerate implementation, other stakeholders — including service providers, users and industry bodies — need to work in collaboration to achieve inclusive growth.

Overall, the expectation from this sector was for the Union Budget to address pending issues from the previous Budget, address regulatory concerns and facilitate the rapid growth of the sector.

Key issues/challenges¹

- Transport and logistics, being a fragmented market, needs to be brought up to speed with the industry requirements, especially with respect to the relatively low Information Technology (IT) penetration, which is resulting in operational inefficiencies.
- Delays in project execution due to regulatory challenges and issues in procedural clearances are resulting in time and cost-overruns.
- There is an unfavourable modal mix that is skewed toward roads as a major mode of transportation, along with under utilisation of other modes — rail, shipping and coastal shipping.
- The deferral of GST implementation has been impacting the readiness of logistics service providers and end users.
- There is a lack of a focussed plan to upgrade skill sets in the wider Indian logistics landscape.
- Bottlenecks in hinterland connectivity have been leading to a high turnaround time in the supply chain.

Government’s stance¹

- Augment government spending on infrastructure to stimulate economic growth
- Focus on roads and highways, and develop rural infrastructure
- Focus on the maritime sector as an important, economical route for bulk transport
- Expedite existing projects and earmark new initiatives
- Revive government and private investments to complement the policy measures announced over the last year

Expectations (policy/fiscal/tax)

- **Infrastructure development**: Introducing new financing schemes for highways and road construction projects, developing an action plan to decongest airports and seaports, shifting cargo-clearance activities to airport locations, in addition to improving hinterland connectivity, would be crucial steps towards developing sound infrastructure. Increased adoption of technology can also help the logistics sector be more efficient. The government is expected to continue to facilitate the development of waterways and logistics parks for faster and more efficient movement of cargo.
- **Expedite decision making**: The introduction of a single-window clearance system can help ensure speedy approvals and timely execution of infrastructure projects to bring in transparency in the overall working system.
- **Improve modal mix**: Policy-based push to channelise the movement of commodities to suitable modes of transportation can help improve the modal mix. Further, the government could look at diverting the transportation of bulk commodities from roads to other appropriate modes, such as railways and waterways, with a view to free up capacity for fast-moving goods.
- **Warehousing**: New policies to set up free trade warehousing zones in India, in addition to infrastructure development for cold chain logistics, can help propel the growth of the sector.
- **Skilled workforce**: Setting up of aeronautical and maritime universities can shift focus to providing sector-specific knowledge and exposure to individuals.

¹ KPMG in India analysis
• **Private investments**: Policy-driven promotion of the PPP model for infrastructure development in the transportation sector, along with plug-and-play projects is an important step.

• **GST**: The introduction of GST is eagerly awaited by trade and industry, therefore, the likely date for GST implementation was expected to be announced in the current Budget.

• **Taxation**: The government could provide clarity on the various direct tax issues, such as:
  - Procedural tax assessment for regular and occasional shipping businesses
  - Exclusion of the service tax portion to levy presumptive tax on income earned by foreign shipping clients
  - Eligibility of tax holidays for CFS/ICDs located in ports
  - Eligibility of tax holidays for MRO, ground handling, cargo and ATF infrastructure co-located at an airport (the draft National Civil Aviation Policy 2015 issued by Ministry of Civil Aviation\(^2\), Government of India has also supported tax holidays for MRO, ground handling, cargo and ATF infrastructure co-located at an airport)
  - Transfer pricing on outbound/inbound legs of freight forwarding transactions, which are currently in litigation before several tribunals and high courts\(^1\)
  - Provide a clear roadmap for corporate tax reduction and removal of MAT
  - Liberal credit rules so as to allow CENVAT credit on rent-a-cab services
  - Withdrawal of the National Calamity Contingent Duty (NCCD) on motor cars, multi-utility vehicles, etc.

In addition, the sector anticipated that the government would provide clarity on tax incentives, such as infrastructure status for port support services and extension of tax incentives for warehouse facilities.

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Key policies/fiscal and tax proposals

Key announcements

The Finance Minister announced a Budget that laid considerable emphasis on infrastructure, as is evidenced from the following key budget proposals relating to the transport and logistics sector.

Sector view

Roads and rail

- The Budget allocated INR19,000 crore to the Pradhan Mantri Gram Sadak Yojna (PMGSY) and a total of INR27,000 crore to be spent on developing rural roads in 2016‒17 with an additional investment from the respective states.
- About 85 per cent of the 70 road projects that were languishing in uncertainty due to legacy factors have been put back into focus for development.
- The government has allocated INR97,000 crore for developing roads and highways in the country (including allocation for PMGSY).
- The government plans to approve 10,000 km of national highways in 2016‒17. Additionally, 50,000 km of existing state highways are to be upgraded to national highways.
- Along with the capital expenditure for railways, the total outlay on roads and rails to be INR2.18 lakh crore for 2016‒17. The total outlay for infrastructure is INR2.21 lakh crore in the same year.
- The Motor Vehicles Act is to be amended to enable entrepreneurship in the passenger segment of the road transport sector. Entrepreneurs may be able to operate buses on various routes, subject to certain efficiency and safety norms.

Ports

- India’s major ports have reportedly handled the highest ever quality of cargo and also witnessed a highest ever capacity increase in 2015.
- The government has been focussing on the modernisation of ports and increasing operational efficiency. The Sagarmala project has been rolled out and the government plans to develop greenfield ports in the eastern and western coasts of the country.
- The government is also focussing on developing National Waterways as a mode of transport, with INR800 crore previously allocated for developing them.
- The Indian Customs Single Window Project, which was announced in the 2014‒15 budget, is to be implemented from FY18.

Civil aviation

- The government plans to revive some of the 160 unserved and underserved airports and airstrips with an investment of INR50 to INR100 crore per project in partnership with the state governments to improve regional connectivity.
- Additionally, the government plans to develop 10 of the 25 non-functional airstrips under the Airport Authority of India.

Others

- The government has also announced new initiatives to streamline the Public–Private Partnership (PPP) model:
  - A Public Utility (Resolution of Disputes) Bill to be introduced in 2016‒17 for the resolution of disputes in infrastructure-related contracts, PPP and public utility contracts.
  - Issuing guidelines for the renegotiation of the PPP Concession Agreements.
  - A new credit system for infrastructure projects, emphasising in-built credit enhancement structures.

Direct tax

- The corporate tax rate remains unchanged.
- Retrospective clarification from 1 April 2001 on the non-applicability of MAT to Foreign Companies. Conditions prescribed:
  - If the foreign company is a resident of a country having DTAA with India but does not have a permanent establishment in India or
  - If the foreign company is a resident of a country having no DTAA with India and there is no requirement of registration under any law related to companies.
- Tax holiday for three out of five years, proposed for eligible startups setup during 01 April, 2016 to 31 March 2019. MAT will be applicable to such startups.
- Period of holding to qualify gains as long term capital gains in the case of shares of unlisted companies to be reduced to two years from three years.
- Benefit of a reduced Long Term Capital Gain tax rate of 10 per cent extended to shares of Private Limited Companies;
- Road map proposed for phasing out deductions includes:
  - Sunset date of 31 March 2017 introduced for commencement of specified activities in case of Infrastructure facilities under Section 80-IA.
  - Weighted deduction of 150 per cent of capital expenditure available has been proposed to be limited to 100 per cent, to specified businesses under section 35AD such as cold chain facilities, warehousing facilities for storage of agricultural produce, etc. from 1 April 2017.
  - Accelerated rate of depreciation to be limited to a maximum 40 per cent from 1 April 2017.
- Place of Effective Management (POEM) based residency test proposed to be deferred by one year;
- GAAR committed to be implemented from 1 April 2017.
- New section introduced for penalties in case of underreported income and misreporting of income. It is proposed to levy a penalty at 50 per cent of tax payable in case of underreported income and penalty of 200 per cent in case of misreporting of facts;
- Rationalising the formula for computation of disallowance with respect to expenditure incurred to earn exempt income under Section 14A read with Rule 8D, to restrict the disallowance upto the amount of actual expenditure incurred.
- Relief granted from higher rate of tax to non-resident from providing Permanent Account Number (PAN) subject to the conditions to be prescribed.
- Reduction in period for completion of normal assessment from two years to 21 months and one year to nine months in case of re-assessment.
- Introduction of Income Declaration Scheme, 2016 for declaring the undisclosed income by domestic taxpayers to be taxed at the rate of 45 per cent (including surcharge and penalties) with immunity from assessment and prosecution.
Indirect tax

- Levy of the, ‘Krishi Kalyan’ cess at the rate of 0.5 per cent on all taxable services w.e.f 1 June 2016, thereby increasing the effective Service tax rate to 15 per cent. The enabling provisions for the availment of the CENVAT credit of the said cess are to be introduced.

- The following activities are subject to service tax:
  - Transportation of goods from outside India to customs stations of clearance in India by vessels
  - Passenger transportation services by air-conditioned stage carriages
  - Transportation of passengers by ropeway, cable car or aerial tramways
  - Services by way of construction, erection, commissioning or installation of original works pertaining to monorail or metros with respect to contracts entered into after 1 March 2016

- Amendments in value on which Service tax is payable in relation to the following services:
  - Transport of goods in containers by rail by any person or entity other than the Indian Railways - service tax is payable on 40 per cent of the value of services (earlier payable on 30 per cent of value of service) subject to conditions of non-availment of CENVAT Credit of inputs and capital goods
  - Services of goods transport agencies in relation to transportation of used household goods - service tax payable on 40 per cent of the value of services (earlier payable on 30 per cent of value of services) subject to the condition of non-availment of the CENVAT credit

- Service tax payable on 40 per cent of the value of services in case of passenger transportation services by air-conditioned stage carriages - subject to the condition of non-availment of CENVAT credit

- CENVAT credit of input services available in case of passenger and goods transport services by the Indian Railways on abated value

- No CENVAT credit reversal requirement in case of the transportation of goods services by a vessel from a place in India to outside India, even where the same does not qualify as an ‘export’

- Infrastructure cess (non creditable) imposed on vehicles at the following rates:
  - 1 per cent on petrol/LPG/CNG driven motor vehicles of lengths not exceeding four metres and engine capacity not exceeding 1200cc
  - 2.5 per cent on diesel driven motor vehicles of lengths not exceeding four metres and engine capacity not exceeding 1500cc
  - 4 per cent on all categories of motor vehicles other than those listed above

- Basic excise duty on parts of railway or tramway locomotives or rolling stock, railway or tramway track fixtures and fittings, etc. reduced to 6 per cent from 12.5 per cent

- The procedure for the availment of exemption from customs duty on import of ships for repair have been simplified
The transport and logistics sector has demonstrated growth in the current year, at the backdrop of a challenging global economic situation. Continuing on the reform agenda, the Union Budget 2016‒17 is built on forward-looking themes towards achieving economic growth, which are expected to provide a strong impetus to the sector.

Policy impact

- An allocation of INR70,000 crore to expedite the creation and expansion of highways, in addition to an investment of INR27,000 crore (along with the state governments) in rural roads is expected to augment economic growth.
- While there were no major announcements to boost the declining growth in ports traffic, the implementation of Sagarmala project along with the continued focus on developing inland waterways are expected to boost the maritime sector in the long term.
- The development of under-served airports and airstrips would help in the decongestion and improvement of connectivity, to facilitate passengers (including tourists) as well as cargo traffic. However, the readiness of the airports and willingness of commercial carriers to commence operations is to be ascertained.
- Proposed amendments in the PPP framework around renegotiation and dispute resolution mechanisms is likely to improve the otherwise discouraging PPP situation; however, rapid implementation of these initiatives is required.

Tax impact

- Increase in the effective service tax rate from 14.5 per cent to 15 per cent
- Increase in the cost of the import of goods by vessels due to the levy of service tax
- Clarification on the non-applicability of MAT provisions with respect to foreign companies can help reduce litigation
- This budget has deferred the applicability of POEM for a year however the Finance Minister has confirmed the implementation of GAAR from 1 April 2017. Other key takeaways from the budget include Action point on BEPS master file and country by country report, reduction in corporate tax rate to 29 per cent for small businesses and phasing out of exemptions implemented.

Impact

The Union Budget 2016–17 has attempted to create an institutional framework for the future. The budget addresses some of the pending issues from the previous budget, regulatory concerns, and includes measures that can help facilitate the infrastructure development and growth of the sector. The government has, however, reserved its views on the GST implementation plan in the current budget.

Infrastructure development

The current Union Budget has a clear focus on developing highways, railways and rural roads infrastructure. The implementation of the Sagarmala project along with the government’s focus on developing National Waterways as a mode of transport indicates its focus on the maritime sector. Further announcements to develop underused airstrips and airports can help drive the aviation sector. The allocation of funds in infrastructure is thus likely to propel the transport, warehousing and logistics businesses rapidly over the medium term.

Addressing the direct tax regime

Overall the provisions of the Budget indicate that the government is committed to provide a stable and predictable taxation regime to reduce litigation and thereby provide a boost to the sector. The transport and logistics sector however expects more clarity on various direct tax issues, such as procedural tax assessment for regular and occasional shipping business amongst others. The expectations of the sector with regard to tax incentives such as infrastructure status for port support services, extension of tax incentives for all warehouse facilities, etc. will also need to be clarified in the near future.

Our point of view
Unfinished agenda

What remains

Direct tax
- Service tax collected on specified shipping income to be excluded in ‘gross freight’ for computing deemed taxable income under Section 44B
- Claiming tax holidays under Section 80-IA by ICD and CFS
- Appropriate guidelines with respect to ‘regular’ and ‘occasional’ shipping businesses
- Extension of the benefits of deduction under Section 80-IA with respect to the upgradation and extension of existing airports
- Tax benefits to Maintenance, Repair and Operation (MRO) companies for setting up facilities in India.

Indirect tax
- Announcement on the date of GST implementation

What is expected going forward

The Budget emphasises on infrastructure development, with the objective of improving operational efficiency and bringing down transportation costs. The following are some of the recommendations that can be considered to help develop a universal roadmap for the sector:

- Channelise the movement of commodities to suitable modes of transportation to improve the modal mix. By diverting the transportation of bulk commodities from roads to increasingly appropriate modes, such as rail and waterways, thereby helping free up capacity for fast-moving goods
- Provide a clear road map for GST implementation to rationalise the overall tax regime, and drive growth in the industry
- Set benchmarks and standards for the industry, to help drive uniformity in warehouses, storage, and transportation equipment, and help bring them up to high quality standards
- Focus on decongesting airports and seaports, shifting cargo-clearance activities to airport, inland or port locations
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