KPMG

Consumer Markets

Union Budget 2017-18

Post-Budget sectoral point of view

#Budget2017 | #KPMGIndiaBudget

kpmg.com/in/budget2017

Setting the context

Where are we

The Indian economy is expected to outperform the global economic growth in FY17 by a significant margin.[1] According to International Monetary Fund's (IMF) revised GDP growth forecast numbers, India might lose its position of being the fastest growing large economy of the world to China. India is registering an estimated GDP growth of 6.6 per cent as against 6.7 per cent for China in FY17, owing to the demonetisation measures taken by the Indian government in November 2016.[2] However, it is anticipated that India would redeem its number one spot from China in FY18.[3]

The early impetus provided by a good monsoon and the Seventh Pay Commission to the consumption demand was offset by the demonetisation drive. This created an adverse impact on sales in sectors, such as Fast Moving Consumer Goods (FMCG), consumer durables and unorganised retail. However, the impact of demonetisation is expected to dissipate in FY18, and result in strengthening of India's institutional framework by reducing corruption, tax avoidance and boosting the organised sector.

Key sectoral highlights:

- India is developing into a strong regional export hub for multinational FMCG players operating in the country, owing to significant market potential, healthy growth rate and favourable demographics
- The e-commerce sector is growing at 51 per cent annually, fastest in the world, and has emerged as one of the key channels for global brands to penetrate the Indian market[4]
- As per the Economic Survey 2016–17, agriculture sector is estimated to register a growth of 4.1 per cent as against 1.2 per cent in 2015–16. Strong growth in the agriculture sector would help increase the rural income and facilitate sales growth of FMCG companies, as one-third of their sales are generated in rural areas[5]

Key issues/challenges

- **Lower income of farmers and inadequate infrastructure for post-harvest management processes**
  - It is important to deal with the challenge of lower income of farmers; there is a greater need of incentives and subsidies for purchasing agricultural inputs, farm mechanisation, adoption of modern agricultural methods, use of technology especially for high-yield variety of seeds, market access, etc.
  - The antiquated storage and distribution infrastructure is a challenge, owing to the inadequately organised cold chain industry, poor storage facilities and transport infrastructure.
- **Lack of a uniform country level policy for important sectors such as FMCG and retail, and lower penetration of organised retail**
  - Absence of national level policy for FMCG, retail and e-commerce. Further, the country's business environment has to go a long way to become conducive for investments
  - There has been a dwindling consumer demand owing to liquidity crunch faced by consumers post demonetisation
  - There is a low penetration of organised players and lack of options for alternate modes of payment – plastic money, e-wallets, online transfer – in tier-III cities, tier-IV cities and rural regions

[1] "http://www.imf.org/external/pubs/ft/weo/2017/update/01/", IMF, January 2017, accessed on 01 February 2017
[2] "http://indianexpress.com/article/business/economy/demonetisation-effect-imf-cuts-india-fy17-gdp-forecast-to-6-6-per-cent-4477529/", Indian Express, 17 January 2017, accessed on 01 February 2017
[3] "http://economictimes.indiatimes.com/news/economy/indicators/imf-cuts-indias-growth-rate-to-6-6-due-to-note-ban/articleshow/56601116.cms", The Economic Times, 17 January 2017, accessed on 01 February 2017
[4] "https://www.export.gov/article?id=India-e-Commerce", Export.gov, accessed on 01 February 2017
[5] "http://economictimes.indiatimes.com/news/economy/agriculture/agri-growth-to-speed-up-to-4-1-survey/articleshow/56891105.cms", The Economic times, 31 January 2017, accessed on 01 February 2017

Government's stance

The Government of India has taken several steps to promote the growth of the consumer markets sector. Some of the key government initiatives taken during the last year include:

- **The government is making continuous efforts to boost the state of the agriculture sector and farmers in the country**
  - In January 2017, the Cabinet Committee on Economic Affairs (CCEA) approved the proposal for establishment of an Indian Agricultural Research Institute (IARI) in Jharkhand, with an estimated cost outlay of INR200 crore[6]
  - As of 30 September 2016, the Indian government has integrated 250 mandis across 10 states in the first phase of implementation of Electronic National Agriculture Market (e-NAM) initiative, launched by it in April 2016. The government has allocated a sum of INR200 crore for this scheme, aimed at facilitating agricultural trade and increasing farmers income.[7]
- **Food processing sector has become one of the key focus areas for the government**
  - The Ministry of Food Processing Industries is under the process of implementing the Scheme for Agro-Marine produce Processing and Development of Agro-clusters (SAMPADA), a novel initiative aimed at facilitating enabling infrastructure, controlled temperature logistics, increasing processing and preservation capacities, and backward and forward linkages, with a budget allocation of INR6,000 crore[8]
  - In June 2016, the Government of India announced to permit 100 per cent FDI under the government approval route, in trading of food products, including e-commerce channel, with an aim to boost the investments in the food processing sector.[9]
- **The government has increased its focus on retail and e-commerce in a bid to raise investments in the sector**
  - The Indian government is considering to permit FDI up to 100 per cent in single-brand retail through the automatic route. Currently, FDI up to 100 per cent is allowed in single-brand retailing; however, investments over 49 per cent require approval from the Foreign Investment Promotion Board (FIPB)[10]
  - In March 2016, the Government of India provided clarity on the marketplace model of e-commerce and permitted 100 per cent FDI through automatic route.[11]
- **Goods and Services Tax (GST) passed by the parliament is likely to have a significant impact on consumer markets sector**
  - In August 2016, the GST bill was passed by the Indian Parliament. The bill upon its implementation is expected to have a noteworthy impact across categories pertaining to the consumer markets. Some firms operating in categories such as FMCG, consumer electronics and food retail might reap the benefits in the form of reduced logistics costs and lowering of taxes. However, other segments, such as soft drink manufacturers and e-tailers might have to pay higher taxes.

[6] "http://www.financialexpress.com/india-news/narendra-modi-reforms-drive-gets-boost-cabinet-clears-insurance-psu-stake-sale-announces-msme-package-more/512720/", The Financial Express, 18 January 2017, accessed on 31 January 2017
[7] "http://timesofindia.indiatimes.com/business/india-business/250-mandis-in-10-states-linked-with-e-agriculture-market-in-first-phase/articleshow/54717191.cms", The Times of India, 06 October 2016, , accessed on 31 January 2017
[8] "http://www.business-standard.com/article/news-cm/government-has-allowed-100-fdi-for-trading-including-through-e-commerce-in-respect-of-food-products-manufactured-or-produced-in-india-117010200299_1.html", Business Standard, 02 January 2017, accessed on 31 January 2017
[9] "http://economictimes.indiatimes.com/industry/cons-products/food/government-allows-100-fdi-in-trading-of-food-products/articleshow/52832819.cms", The Economic Times, 20 June 2016, accessed on 31 January 2017
[10] "http://www.financialexpress.com/economy/reforms-in-india-narendra-modi-govt-mulls-100-fdi-in-single-brand-retail-through-auto-route/512218/",The Financial Express, 18 January 2017, accessed on 31 January 2017
[11] "http://www.thehindu.com/business/Industry/govt-permits-100-per-cent-fdi-in-online-market-places/article8409495.ece", The Hindu, 30 March 2016, accessed on 31 January 2017

Expectations[12,13]

- Boost to agriculture in the form of new schemes and allocations[14]
  - Increased allocation for agro-forestry to approximately INR100 crore
  - Doubling the allocation towards drip irrigation to INR3,000 crore from the existing INR1,500 crore
  - Launch of new scheme to develop organic clusters, increasing the number of organic clusters from 10,000 to more than 100,000
  - Increased allocations to marquee programmes, such as 'Pradhan Mantri Krishi Sinchai Yojana', 'Rashtriya Krishi Vikas Yojana', 'Pradhan Mantri Gram Sadak Yojana' and soil health programme.[15]
- Encouraging cashless transactions by incentivising payments through e-wallets and plastic money, boosting the organised retail markets
  - Reduction in excise duty on mobile phones manufacturing industry to boost digitalisation of economy and to promote the vision for a cashless economy
- Measures to provide clarity on GST implementation
  - Announcement of a clear GST roll-out plan
  - Rationalisation of the tax structure by removing various cess and surcharge on goods and services as the same are likely to converge into GST
  - Taxation of consumer durables at 18 per cent instead of 28 per cent under the GST regime to give impetus to consumption and promote rural development
- Policy support to create and modernise logistics and supply chain infrastructure
- Increased taxes on tobacco and alcohol, as they are a perennial source of revenue
- Initiatives to boost the 'Make in India' initiative:
  - Surge in prices of imported goods, such as high-end electronics, luxury goods and automobiles, as well as gold and jewellery, to increase the government's indirect tax revenues post GST implementation
  - Announcement of incentives for setting up manufacturing units in the country to help stimulate Foreign Direct Investments (FDIs)
  - Tax incentives for labour-intensive industries, such as leather and gems and jewellery, to boost manufacturing, create employment opportunities and revive exports
  - Fiscal boost to mega industrial hubs or clusters comprising production units, residential areas, schools and hospitals, public utilities, etc., similar to the ones in China
- Stimulus packages targeted towards MSMEs/SMEs to boost the country's economy.

Direct taxes

- **Reduction in tax rates/tax incentives**
  - Reduction in corporate tax rates, including Minimum Alternate Tax (MAT) rates, for corporate entities
  - Alteration in the income tax slabs to increase disposable incomes at the hand of consumers
  - Extension of sunset clause under Section 80IE of the Income Tax Act, 1961, to provide stimulus to the agriculture sector in form of food processing activity
- **Tax incentives for start-ups**
  - Increasing investment allowance coverage under Section 32AC of the Income Tax Act, to cover start-ups by reducing the threshold for investment in new plant and machinery

[12] "Budget Expectations FY17-18", Thomson Investext Database, 27 January 2017, accessed on 31 January 2017
[13] "http://www.cbgaindia.org/wp-content/uploads/2016/12/Suggestions-on-Union-Budget-2017-18.pdf", CBGA, 15 December 2016, accessed on 31 January 2017
[14] "https://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=2016-12-26%2013:49:12&msec=866", CMIE, 26 December 2016, , accessed on 31 January 2017
[15] "http://www.business-standard.com/budget/article/sector-wise-key-expectations-from-budget-2017-117012000751_1.html", The Business Standard, 20 January 2017, accessed on 31 January 2017

  - Extension of the recently amended Section 44AD of the Income Tax Act to incentivise taxpayers earning income from commission/brokerage or undertaking agency business

- **Relaxation in FDI regulations**
  - Multi Brand Retail Trading (MBRT): Permission for 100 per cent FDI in certain MBRT segments such as food, electronics and luxury items could be allowed to enable investments in supply chains and allow a larger number of global brands access the Indian market
  - Single Brand Retail Trading (SBRT): Provide greater clarity on terms such as 'state of art' or 'cutting-edge technology' to promote foreign investment.

- **Clarity on transfer pricing provisions**
  - Stem litigations by providing clear guidelines on adjustments related to advertisement and brand promotion expenditure to promote ease of doing business in India.

Key policy proposals

Key announcements

Non-tax

Agriculture and allied

- The overall allocation to the rural, agriculture and allied sectors has been increased by 24 per cent year-on-year to INR187,223 crore for 2017–18
- **Agricultural credit target is fixed at INR10 lakh crore for 2017–18**, with special efforts to enhance the adequate credit flows to the under-serviced areas, eastern states and Jammu & Kashmir
- Allocations to the National Bank for Agriculture and Rural Development (NABARD):
  - **Computerisation and integration** of 63,000 functional Primary Agriculture Credit Societies (PACS) is planned over a period of three years at an estimated cost of INR1,900 crore
  - An **additional INR20,000 crore has been allocated for long-term irrigation fund** under NABARD (announced by the PM in September 2016), taking the total corpus of the fund to INR400,000 crore
  - The government would **set up a dedicated micro irrigation fund** under NABARD with an initial corpus of INR5,000 crore
  - The government would **set up a dairy processing and infrastructure development fund** under NABARD with a corpus of INR8,000 crore over three years. The fund would start with an allocation of INR2,000 crore initially.
- **Increase in coverage of Fasal Bima Yojana (FBY)** from 30 per cent of the cropped area to 40 per cent of the cropped area in 2017–18 and to 50 per cent of the cropped area in 2018–19. Therefore, a sum of INR9,000 crore has been provided for FBY for 2017–18
- **Increase in the allocation of corpus for Pradhan Mantri Krishi Sinchai Yojana (PMKSY)** to INR7,377 crore, aggregated across three ministries
- **The expansion of coverage of National Agricultural Market** (e-NAM) from current 250 Agricultural Produce Market Committee (APMC) to 585 APMC. Further, assistance of up to INR75 lakh is to be provided for every e-NAM market for establishment of cleaning, grading and packaging facilities
- Proposal to **integrate fruits and vegetables (F&V) farmers with agro-processing units**. Thus, a model law on contract farming would be prepared to be circulated amongst states for adoption

- **Increase in budget provision under Mahatma Gandhi National Rural Employment Guarantee Act** (MGNREGA) from INR38,500 crore in 2016–17 to INR48,000 crore in 2017–18. Geo-tagging and space technology are also being used for greater transparency and planning, and to support the government's resolve to double farmers' income.

FMCG and retail

- **Special scheme to create employment in the leather and footwear industries** would be launched, on similar lines to the scheme launched in the textile sector
- **Allocation for schemes,** such as Modified Special Incentive Package Scheme (M-SIPS) and Electronics Development Fund (EDF), **focussing on electronics manufacturing** increased to INR745 crore for 2017–18
- **Phasing out of the Foreign Investment Promotion Board** (FIPB) in 2017–18 for further liberalisation of Foreign Direct Investment (FDI).

Tax

Agriculture and allied sectors

- Basic Customs Duty (BCD) on nylon mono filament yarn has been lowered from 7.5 per cent to 5 per cent, to be used in monofilament long line system used for tuna fishing (subject to certain specified conditions)
- BCD on cashew nut (roasted, salted or roasted and salted) increased from 30 per cent to 45 per cent.

FMCG and retail sectors

- Miniaturised Point of Sale (POS) card reader for m-POS, iris scanners, fingerprint readers/scanners and micro ATM standards version 1.5.1 have been exempted from BCD, excise/ Countervailing Duty (CVD) and Special Additional Duty (SAD), with an aim to promote cashless transactions
- BCD reduced from 7.5 per cent to 2.5 per cent for vegetable tanning extracts — Wattle extract and Myrobalan fruit extract, used to produce finished leather
- BCD and CVD rates have been revised to 5 per cent and 6 per cent, respectively, for all parts used in the manufacture of LED lights or fixtures (subject to actual user condition)
- Excise duty on all tobacco products, excluding bidis, has been increased in the range of 2.5 and 6 per cent.[16]

Direct tax

- In a bid to increase the competitiveness of MSME companies in the country, the corporate tax rate has been reduced to 25 per cent for companies with an annual turnover of up to INR50 crore
- Tax rate for individual assesses earning income between INR2.5 lakh to INR5 lakh reduced from 10 per cent to 5 per cent
- The profit (linked deduction) exemption available to start-ups for three years out of five years is now changed to three years out of seven years
- Brought forward losses not to lapse for start-ups, in case all shareholders which held shares (carrying voting power) on last day of the year in which loss is incurred, continue to hold those shares on last day of year in which such loss is to be set off
- Beneficial provisions of Section 44AD extended beyond FY 2016-17

[16] "http://www.livemint.com/Industry/tvCef3z3lekprQL9pOcj3I/Budget-2017-Jaitley-hikes-excise-on-cigarettes-by-up-to-6.html", Livemint, 01 February 2017, accessed on 01 February 2017

Impact

- By increasing the agricultural credit target to INR10 lakh crore, the government has focussed on farmers' security. Similarly, it has also increased the allocations for the crop and farmer insurance schemes, such as FBY and PMKSY, to secure farmers from the consequences of natural calamities. Increased funding to NABARD through various schemes, such as micro irrigation and dairy processing, also supplement the government's concern towards farmers' financial security and agricultural development
- The allocation of additional funds to MGNREGA to boost rural employment is likely to improve the income of farmers, which would sustain the government's goal to double the income of farmers by 2022. Furthermore, the expected increase in the purchasing power of farmers could eventually boost the rural consumption, benefitting the consumer goods and retail companies in rural areas
- The focus on contract farming by introducing a model law is likely to provide better prices to farmers, by reducing the role of a middlemen
- Concessions offered to various manufacturers making devices facilitating cashless transactions is further expected to boost the government's agenda to drive a digital and cashless economy, and are likely to help small retailers to afford these devices
- With a majority of tobacco products been kept out of the GST purview, an increase in excise duty for the category was anticipated for this year as well. However, the increase of excise of 2.5–6 per cent on tobacco products was relatively better for the manufacturers rather than the estimated range of 10–15 per cent. Hence, the permissive stance of the government is not expected to upset the sales
- The move to lower tax rates from 10 per cent to 5 per cent on individual income in the range of INR2.5 lakh and INR5 lakh would increase the disposable income, thus propelling the consumption levels. This is also likely to widen the tax base in the country as more individuals are likely to pay taxes willingly
- An increase in the allocations to schemes supporting electronics manufacturing, such as M-SIPS and EDF, would promote manufacturing of electronic equipment and devices in the country. Further, an additional Special Additional Duty (SAD) of 2 per cent on populated Printed Circuit Boards (PCB) used in mobile phones imported within the country would provide adequate protection to the domestic mobiles manufacturing industry and encourage local production
- Reduction in corporate income tax for companies with an annual turnover of under INR50 crore would provide a fillip to the medium and small scale enterprises, helping the cause of 'Make in India' initiative, especially the consumer companies and food processing industry where the government has already announced 100 per cent FDI
- The extension of reduced rate of deemed profits to 6 per cent beyond FY2016-17, under the Section 44AD of the Income Tax Act, is likely to reduce the tax burden on small retailers and promote digital transactions
- The initiatives in the infrastructure sector — roads, railways, rivers, airways, etc. — are likely to help improve the supply chain and back-end logistics for the consumer sector.

Unfinished agenda

What remains

- The need for a fiscal boost and policy incentives to push mega industrial hubs in the country, similar to ones in China for various facilities. This could also lead to a major fillip to the government's 'Make in India' initiative
- Incentives and measures to boost the cold chain storage and warehouse networks
- Increase of import duties on consumer durables, such as white goods, as GST may make imports cheaper in certain categories
- Widening of the purview to Section 32AC of the Income Tax Act to cover SMEs, reducing the threshold for investment in new plant and machinery, and extending such provisions for more years
- The extension of provisions of Section 44AD to taxpayers' earning income from commission/brokerage or undertaking agency business.

What is expected going forward

- The government has announced several schemes to promote long-term growth in rural, agriculture and allied sectors. However, the clarification and implementation guidelines lack clarity on some of these schemes. As next steps, the government is expected to provide transparency on policy details of the model law on contract farming, which could impact the entire farm value chain and provide benefits, such as better realisation to farmers, reduce middlemen and bring in more investments into the sector.
- In June 2016, the government launched a special package for job creation and export promotion in the textile and apparel sector to create more jobs (especially for women), increase textile and apparel exports, and attract investments. The government is expected to launch a similar scheme for the leather and accessories industries in FY18, according to the Union Budget announcements. The industry stakeholders would be keen to see the incentives offered in the new scheme.
- The plan to abolish the Foreign Investment Promotion Board (FIPB) is expected to ease the process of investing through the FDI route in the country. However, the government needs to provide clear guidelines on the FDI approval process, as many sectors, such as single-brand and multi-brand retail, still require the FIPB approval. In the retail sector, a more liberal FDI policy on both SBRT and MBRT can boost foreign investments in the sector.
- The government re-affirmed the commitment to implement the Goods and Services Tax (GST) within the stipulated timeline and highlighted that its progress is well on track, including IT preparedness. However, the government would have to determine that the uniform implementation of GST take place in its agreed form in an efficient manner and is not delayed any further. For this to happen, the government needs to chalk out a clear roll-out plan for GST implementation in a timely sequence. Additionally, state governments will also have a vital role to play in GST implementation.
- Uncertainties around commodity prices, especially crude oil, could push the prices of some of the consumer products in the upcoming fiscal year.

KPMG in India contacts:

Nitin Atroley
Partner and Head
Sales and Markets
T: +91 124 307 4887
E: nitinatroley@kpmg.com

Rajat Wahi
Partner and Head
Consumer Markets
T: +91 124 307 5052
E: rajatwahi@kpmg.com

Follow us on:
kpmg.com/in/socialmedia