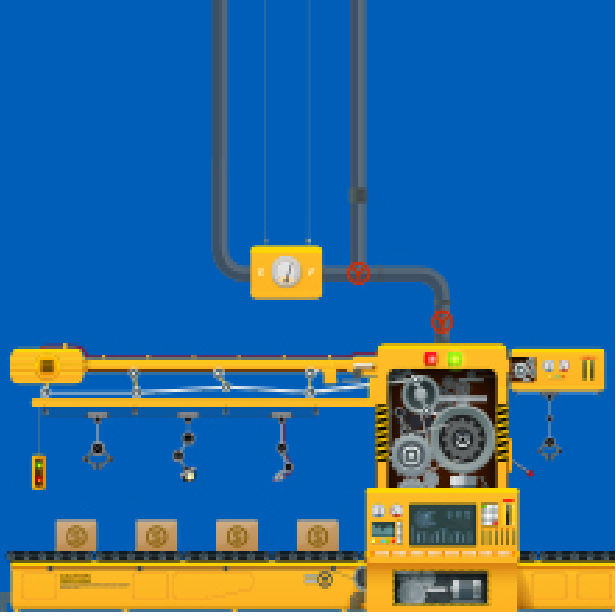
KPMG

Union Budget 2018-19

Our Point of View

Industrial Manufacturing



Enhanced focus on developing the rural economy and country's infrastructure to drive growth for Manufacturing

Budget analysis

With the implementation of the Goods and Services Tax (GST) in July 2017, except for Custom Duty, the industry did not expect any major reforms for Indirect Tax. However, there was definite expectation of favourable change in direct tax that could give a push to the 'Make in India' initiative and thereby attract investments from private players.

Union Budget 2018-19 primarily focussed upon strengthening other key pillars of the Indian economy including agriculture, healthcare, and infrastructure, besides special focus on rural markets. While the Budget may not directly impact the Manufacturing sector, the government's increased spending on the above-mentioned sectors is expected to give fillip to the domestic Manufacturing sector.

- Addressing the overall needs for infrastructure creation in the country, the government has made an all-time-high allocation of INR5,970 billion, an increase of 21 per cent over FY2017-18 allocation. Additionally, the government has allocated INR14,340 billion for livelihood creation and developing rural infrastructure. Major announcements related to infrastructure and rural development that could positively impact the Manufacturing sector (especially steel, cement and construction equipment) are: Under the Bharatmala Pariyojana, the government aims to build 35,000 km of roads at an estimated cost of INR5,350 billion
- Under the Prime Minister Awas Scheme Rural, the government plans to construct more than 1 crore houses in rural areas by the end of FY2018-19
- Under the Swachh Bharat Abhiyan, the government plans to construct 2 crore toilets
- The government plans to double 18,000km of railway track and gauge conversion of 5,000km
- It also plans to invest INR110 billion and INR170 billion in strengthening Mumbai's transport system and Bengaluru's metropolis, respectively.

Furthermore, the Budget was largely focussed on uplifting the Agricultural sector which was evident from the budgetary allocation that went up by 15.6 per cent to INR581 billion for FY2018-19. In addition, the government declared 150 per cent hike in Minimum Support Price (MSP) for majority of crops, and announced an institutional credit of INR11,000 billion for the Agriculture sector.

To sum up, Union Budget 2018-19 was much against the expectations of promoting 'Make in India' and there were no major announcements to boost local manufacturing in the country. However, surge in infrastrucutural investment can drive demand for some sub-sectors, and increase in Custom Duty in certain electronic goods and automotive components may influence the manufacturing of these items in India.

Budget impact

- Increasing rural spend, coupled with parallel focus on development of urban infrastructure such as smart cities and national highways, is expected to provide continued impetus to the overall economic activity, thereby positively affecting the growth of key subsectors of manufacturing such as metals, building materials, construction equipment, commercial vehicles and two-wheelers
- Increased creation of infrastructure such as roads and airports would connect more areas, thereby easing bottleneck, which can positively impact the ease of doing business, thus attracting more investment for the Manufacturing sector
- Government's aim to double the farmer's dispensible income by 2022 by giving boost to the Agricultural sector is likely to drive the demand for segments such as pump, tractors and other agri-machineries, along with commercial vehicles and two-wheelers
- The Budget has proposed increase in Custom Duty for Completely Built Unit (CBU) motor vehicles and certain auto parts, which could lead to increase in price in certain segments of luxury vehicles. Additionally, the increase in Custom Duty on auto components and certain electronic products could help drive the 'Make in India' initiative
- There is a strong focus on developing the country's food processing sector as the budgetary allocation has been doubled, which is likely to have a positive impact on the packaging sector
- Government's plan to lower the corporate tax to 25 per cent for companies with revenue up to INR2.5 billion is likely to benefit the Micro, Small and Medium Enterprises (MSMEs), which is the backbone of the Manufacturing sector. This move is likely to give them an impetus to make further investments, thereby triggering growth of the sector.

Key announcements

Tax

Direct Tax

- Benefit of corporate tax rate of 25 per cent extended for domestic companies with annual turnover or gross receipts upto INR2.5 billion in FY2016-17. Education cess has been discontinued and new 'Health and Education Cess' of 4 per cent has been introduced. No change in surcharge rates.
  - The reduction in the corporate tax rate is significant compared to increase in the rate of cess, which would result in tax savings and increased disposable funds with the manufacturing/automotive companies which in turn can be ploughed back into the sector.
- Additional deduction of 30 per cent is allowed in respect of emoluments paid to eligible new employees who have been employed for a minimum period of 240 days during the first year of employment. This benefit is now allowed even in respect of a new employees who are employed for less than the minimum threshhold of 240 days during the first year but continue to remain employed for 240 days in the subsequent year.
  - This would enable employers in the Manufacturing and Automotive sector to claim incentives even in the scenario stipulated above and use the tax savings for their business and paying higher wages.
- Farm produce companies having total turnover of upto INR1 billion in a year will be entitled for a 100 per cent tax deduction of its profits from the below activities starting from FY2018-19 until FY2023-24 which could indirectly boost the players engaged in manufacturing of agricultural equipment:
  - Marketing of agricultural produce grown by members
  - Purchase of agricultural implements and other articles for supplying it to members
  - Processing of agricultural produce.
- The scope of the term 'business connection' for taxation of non-residents has been enlarged in light of the provisions of Base Erosion and Profit Shifting (BEPS) Action Plans and Multilateral instrument (MLI), the concept of 'significant economic presence' (in addition to the physical presence) of non-resident has also been incorporated within the scope of 'business connection'.
  - This could cover the newer business models such as digital economy emerging due to advancement in information and communication technology and thus could impact the foreign manufacturing and automotive players who are selling in India without physical presence.

- Long-Term Capital Gains exceeding INR0.1 million on transfer of listed equity shares or units of equity oriented mutual funds will be taxable at 10 per cent. However, mechanism has been prescribed for grandfathering of gains accrued upto 31 January 2018. This could impact the existing as well as the inflow of fresh investments in the domestic sector.
- Compensation, whether revenue or capital, for or in relation to termination or modification of contract of business or employment has been made taxable. This can impact the auto components and the Original Equipment Manufacturer (OEM) sector, as any claim would now be taxable.
- Many provisions of Income Computation and Disclosure Standards (ICDS) which became applicable from FY2016-17 were struck down as unconstitutional by a recent Delhi High Court decision[1]. It is now proposed to incorporate certain provisions of ICDS in the Income-tax Act, 1961 itself, effective FY2016-17, to make it part of the legislation. Key changes are in relation to income accrual from government grants, treatment of mark-to-market losses etc.
- The companies seeking insolvency resolution under the Insolvency and Bankruptcy Code 2016 (IBC), are provided relief on tax arising due to book profit (Minimum Alternate Tax), on account of write back of debt; relief to allow carry forward of losses even if majority voting rights undergo change; and deduction of aggregate sum of book loss and unabsorbed depreciation in computing book profits under MAT. This is a move in the right direction to mitigate unwarranted tax burden on such companies which was contrary to the spirit of the IBC to expedite the resolution and recovery process of the stressed assets
- Time limit revised for filing Country-by-Country Report (CbCR) by a Parent or Alternative Reporting Entity (ARE) residents in India.
- CbCR to be filed in India in case overseas Parent entity has no obligation to file CbCR and Parent entity has not nominated ARE.

Indirect tax

Key announcements

Custom Duty

- Education Cess and Secondary and Higher Education Cess on imported goods has been abolished. However, Social Welfare Surcharge (SWS) at the rate of 10 per cent has been levied on import of goods. This will marginally increase the cost of imported goods.
- Automobile sector may be impacted due to increase in Basic Custom Duty (BCD):
  - From 10 per cent to 15 per cent on import of motor vehicles, motor cars, motor cycles in THE Completely Knocked Down (CKD) form
  - From 20 per cent to 25 per cent on import of motor vehicles in the Completely Built-Up (CBU) form
  - From 10 per cent to 15 per cent on import of radial tyres of truck and bus
  - From 7.5 per cent to 15 per cent on import of spark/compression ignition engine and their parts for specified motor vehicles and motor cycles
  - From 7.5 per cent to 15 per cent on import of ignition or starting equipment and cut outs for motor vehicles or motor cycle
  - From 10 per cent to 20 per cent on seats and parts of seats used in motor vehicle
- Manufacturing of LCD/LED television to get costlier as Custom Duty has been levied at 10 per cent on certain parts required for manufacture of LCD/LED TV panels.
- Other key changes in BCD are:
  - Printed Circuit Board Assembly (PCBA) of charger/adapter and moulded plastics of charger/adapter of cellular mobile phones increased from Nil to 10 per cent
  - Ball screws, linear motion guides, CNC systems for manufacture of all types of CNC machine tools (falling under headings 8456 to 8463) decreased from 7.5 per cent to 2.5 per cent

[1] The Chamber of Tax Consultants & Anr. v. UOI [W.P.(C) 5595/2017 & CM APL 23467/2017

— BCD is exempted on import of input or parts for manufacture of Printed Circuit Board Assembly and moulded plastics of charger/adapter of cellular mobile phones

— BCD is exempted on import of solar-tempered glass or solar-tempered anti-reflective coated glass for manufacture of solar cells/panels/modules.BCD is increased to 5 per cent on import of preform of silica for use in the manufacture of telecommunication grade optical fibres or optical fibre cables.

On the Indirect Tax front, we see a clear trend to support the 'Make in India' initiative. While increase in Custom Duty on auto parts including engines is likely to push up the prices of vehicles with heavy imported content, the Government expects this to kick start indigenisation of technology so that more value is added within the country than mere assembly. Exempting custom duties on parts of PCB assembly while increasing duties on fully assembled PCB for mobile charger is also an example of the same thought process. Whether this will really result in transfer of value addition to India and resultant increase in jobs, skill levels and technological competence can be seen only after a few years.

KPMG in India contacts:

Mritunjay Kapur
National Head - Markets & Strategy
Head - Telecom, Media and Technology
T: +91 124 307 4797
E: mritunjay@kpmg.com

kpmg.com/in/socialmedia