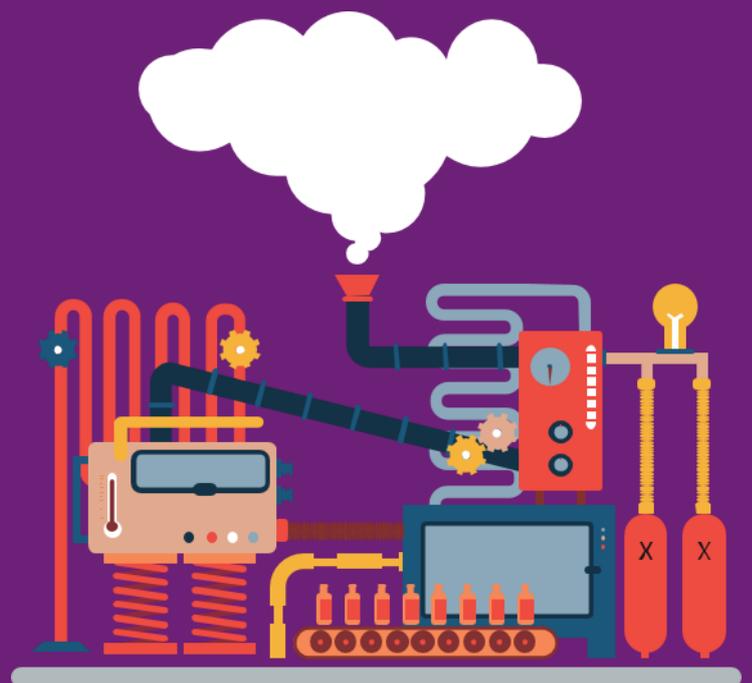




# Industrial Manufacturing

## Union Budget 2016

Post-Budget sectoral point of view



#Budget2016 | #KPMGIndiaBudget

<http://www.kpmg.com/IN/budget2016>

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# Context

## Where we are



- The 'Make in India' initiative launched 18 months ago has since been successful in capturing the mind share of stakeholders across the world. However, there are several reforms - including land and labour laws, and Goods and Service Tax (GST) - that are still expected to take shape, to improve ground level manufacturing
- Challenging economic environment in both global and domestic markets have pushed manufacturing sentiments to levels bordering skepticism. Several direct economic indicators, such as capacity utilisation, productivity and employment generation, and the level of Non Performing Assets (NPAs) (primarily in manufacturing sector) portray a different picture when compared with healthy GDP growth rates
- Primarily, both low demand and softening commodity prices have hampered the Indian manufacturing industry to a great extent. The drop in global commodity prices has benefitted some sectors to control their input cost, but for others, it has been neutralised by diminishing output prices. The market is also going through a tough price competition locally, and witnessing pressure on imports from countries, such as China, which has excess capacity
- Having made a brilliant start with the 'Make in India' campaign, the Budget was expected to address all operational elements with an aggressive road map to implement the necessary initiatives/reforms.

## Key challenges



- Despite continuous emphasis on developing infrastructure, it is still considered to be one of the major bottlenecks for the manufacturing sector
- A flat demand curve, coupled with falling output prices, is leading to lower sales realisation
- There has been an increase in cost-effective imports of products, such as steel and chemicals, from low-cost countries, mainly China. (E.g., steel imports from China rose by approximately 70 per cent in FY2015-16 from the previous year<sup>1</sup> has led to increase in margin pressure on domestic companies)
- There have been no fresh investments in green field or brown field projects by domestic companies
- Delay in implementation of GST has resulted in continuation of complex tax laws
- Significant debt-burden, followed by unfavourable market conditions, is making it difficult for companies to repay debts. (As per analysts, Indian steel producers alone are carrying a debt of INR3 lakh crore)<sup>2</sup>
- Complex tax laws and land acquisition policy, are considered as key challenges for companies planning to/investing in India.

1. Indian steel industry loses out to cheaper imports, Live Mint, 9 June 2015  
 2. Steel sector seeks govt support on lines of textiles, sugar, Money Control, 11 Jan 2016

## Government's stance

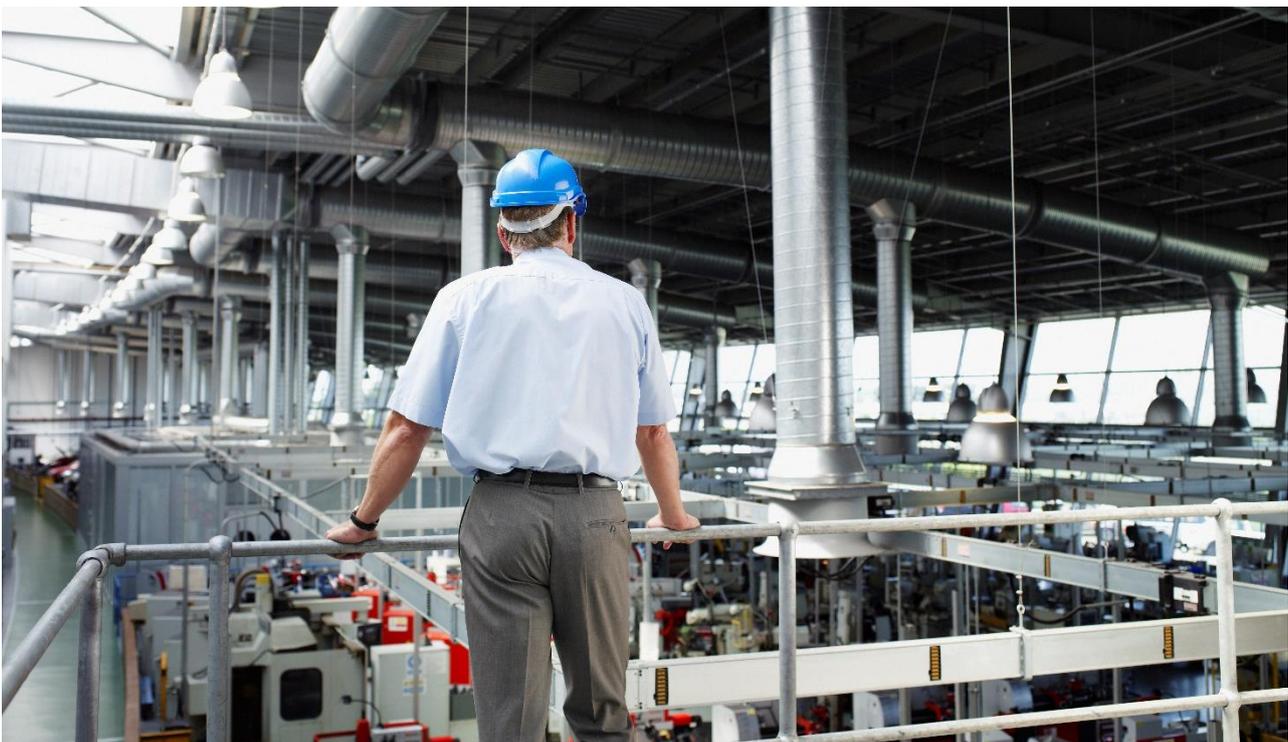


- The government is committed to promoting the manufacturing sector as an engine of growth. The launch of 'Make in India' initiative, aimed at creating millions of jobs opportunities and making the country a global manufacturing hub, was the primary step toward it. To accomplish the target, the government is focussing on improving the country's infrastructure by increasing investments and improving ease of doing business by simplifying tax laws and labour reforms
- Recently, the government launched a series of other initiatives, such as 'Smart Cities', 'Skill India', 'Start-up India', which directly or indirectly are meant to propel the 'Make in India' programme.

## What was expected



- Incentivise investments from domestic and global players by formulating lucrative policies for their benefit
- Focus on building common facilities to facilitate industry cluster increasing the level of integration across industries which can help in achieving economies of scale
- Creation of infrastructure facilities to reverse the bottleneck in terms of inbound and outbound logistics
- Improve global competitiveness by incentivising innovation and Research and Development (R&D) on manufacturing
- Drive early implementation of GST that would simplify the tax structure and facilitate smooth inter-state movement of goods
- Simplify labour laws and further improve the ease of doing business to attract investments in the manufacturing sector
- Promote Micro, Small and Medium Enterprises (MSME) segment by providing incentives, easy access to finance and manufacturing input, which would help them withstand the highly competitive environment.



# Key policies/fiscal and tax proposals



## Key announcements<sup>1</sup>

- An investment of about INR97,000 crore on road construction (including rural) has been made to develop 10,000km of national highways in FY17, 50,000km of state highways are to be converted to national highway (NH) roads and the development of new greenfield ports are expected to address the logistics bottlenecks, and could trigger the demand for basic commodities, such as cement and steel
- Increase in 'clean environment cess' to be levied on coal, lignite and peat from INR200 per metric tonne (PMT) to INR400 PMT. In effect, the steel industry using coal (both coking and non-coking, including imported) may have to bear an additional financial burden of INR200 per tonne of coal purchased. This could adversely affect the iron and steel industry, including the sponge iron, pig iron, ferro-alloys units
- The government also plans to amend the Companies Act, 2013 that would enable registration of new companies in one day and would remove the difficulties concerning ease of doing business in the country
- To improve ease of doing business, the government has proposed to introduce a Centre State Investment Agreement, which would ensure the execution of investment treaties signed by India with foreign countries
- The government is planning to set up 1,500 multi skill training institutes across the country, under the 'Pradhan Mantri Kaushal Vikas Yojana'. This could help the Indian manufacturing sector to overcome the issue of unskilled labour in India.
- Income by way of royalty in respect of patents developed and registered in India by a resident in India is to be taxed at the rate of 10 per cent (plus surcharge and cess) on a gross basis. The income will not be subject to MAT
- Place of Effective Management (POEM) with effect from 2016-17 (instead of FY2015-16). The government needs to notify income computation mechanism in case a foreign company is said to be resident in India due to it having a POEM in India
- Hundred per cent deduction for a period of three consecutive years out of the initial five years for eligible 'start-ups' which are set-up before 1 April 2019 and whose turnover does not exceed INR250 million in any FY from 1 April 2016 to 31 March 2021.
- GAAR to be applicable with effect from 1 April 2017
- In order to reduce the disputes relating to quantification of disallowance of expenditure relatable to exempt income, the disallowance shall be limited to 1 per cent of the average monthly value of investments yielding exempt income, but not exceeding the actual expenditure claimed (Amendment proposed in the Budget speech, however, not mentioned in the Finance Bill)
- A buy-back tax is applicable to any buy-back of unlisted shares under the provisions of Companies Act, 1956 and is not restricted to Section 77A of the Companies Act, 1956. The rules are to be prescribed to compute the distributed income under different scenarios, including shares issued under tax business re-organisations and in different tranches. The amendment is to be applicable from 1 June 2016.
- Long Term Capital Gain (LTCG) derived by non-residents from the transfer of shares of a closely held private limited company is taxable at the rate of 10 per cent
- In line with the recommendations contained in the Organisation for Economic Co-operation and Development (OECD) report on Action 13 of the BEPS Action Plan, the three-tiered (i.e. master file, local file and CbyC reporting) transfer pricing documentation structure has been proposed to be adopted for specified companies.

## Direct tax proposals:

- There has been no change in the corporate tax rate, except for the same applicable to new eligible manufacturing companies which are taxable at 25 per cent without claiming specified deductions, allowances, depreciation, and companies having a turnover or gross receipts not exceeding INR50 million, taxable at 29 per cent
- Dual condition for acquisition and installation of new assets for claiming deduction u/s. 32AC of the Income Tax Act has been done away with, and now deduction u/s. 32AC of the Income Tax Act can be availed in respect of new assets installed up to 31 March 2017
- Accelerated depreciation to be limited to maximum of 40 per cent

1. Union Budget 2016-17, <http://indiabudget.nic.in/glance.asp>, 29 February 2016

**Indirect tax proposals:**

On indirect taxes front, while there are several thrust areas, the primary focus of proposals appears to be towards promoting 'Make in India' and 'Ease of Doing Business' initiatives of the government.

**General:**

- No change in peak rates under service tax, excise duty and customs duty
- Custom and excise duty rate structure re-aligned to give boost to domestic manufacturing of several products.

**Customs:**

- Facility of deferred payment of customs duty to be extended to specified importers and exporters
- Eleven new benches of customs, excise and service tax Appellate Tribunal to be created to clear backlog of cases
- Customs single window project to be implemented at major ports and airports from next financial year.

**Excise:**

- Excise returns can now be revised by the end of month in which they are submitted
- Period of limitation seeking recovery of excise duty in specific cases extended from one year to two year
- Penal rate of interest under central excise reduced from 18 per cent to 15 per cent.

**Service Tax:**

- 'Krishi Kalyan' cess to be imposed at the rate of 0.5 per cent on all taxable services and infrastructure cess imposed up to 4 per cent on specified motor vehicles
- Interest on service tax fixed at 15 per cent for all defaults except in case where service tax is collected and not deposited where interest shall be 24 per cent
- To avoid overlap between service tax and excise/customs, new exemption Notification introduced in relation to IT software recorded on a media in respect of which Retail Sale Price (RSP) is required to be declared under the provisions of Legal Metrology Act.

**Our point of view**

The Union Budget largely focussed on agriculture, rural development and improving the country's infrastructure. Investments in road and rail can help the manufacturing sectors significantly. This should debottleneck inbound and outbound logistics challenges that manufacturing companies go through today.

Investments in infrastructure could spur the demand in allied manufacturing sectors such as cement, steel and construction equipment.

Furthermore, a strong focus on developing the agriculture sector and developing the rural economy of India is likely to put money in the hand of rural India that would drive the demand across different sector.



# Unfinished agenda

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## What remains

- **GST implementation:** The manufacturing sector was expecting an early implementation of GST, which was supposed to simplify taxation.
- **Land acquisition reforms:** The success of 'Make in India' initiative is significantly dependent on an effective land acquisition policy.
- **Incentives for domestic/local investments in manufacturing:** No significant announcements were made on promoting/supporting domestic investments.
- There was no announcement on the creating common facilities for an industrial cluster.





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