Grant Thornton
An instinct for growth™

Union Budget 2015-16

Impact on the Automotive sector

Contents

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Sector overview

Sector overview

- Automotive sector occupies a prominent place in the Indian manufacturing industry. As a result of its forward and backward linkages with several key segments of the economy, the automotive industry has a strong multiplier effect and has the potential to be the driver of economic growth
- India has become the outsourcing hub for several global automobile manufacturers
- Auto companies save 10-25% on operations vis-à-vis their European and Latin American operations. With the availability of a large pool of skilled manpower and a growing technology base, a large number of global auto manufacturers are investing in India
- The sector currently accounts for almost 7% of India's gross domestic product (GDP) and employs about 19 million people, both directly and indirectly
- Ever-increasing development in roadways and other infrastructure facilities, a big domestic market, rising incomes and a stable government has increased the customer base for the automobile sector

Growth drivers

The key growth drivers are:

- a strong demand, product innovation, strong policy support and easier access to credit
- Rising income and middle-class population driving growth in domestic demand
- Boost to research and development in auto components sector
- India's huge geographic spread – Mass Transport System
- Growing demand for second hand vehicles in urban areas

Sector overview

Challenges

- Increasing consolidation across industries driven by competitive cost pressures, high growth in emerging economies and greater partnerships and alliances
- Global suppliers have a smaller presence in India whilst domestic vendors have a low focus on product quality, production process systems and innovation etc
- Increasing competition in the Indian automotive industry has led to significant shrinkage in product lifecycles and management of a wide portfolio. A related key issue is the proliferation of parts/components, driven by the need for providing spare parts for current as well as discontinued models
- “One size fits all” approach cannot be adopted for customers as well as business partners
- Poor road infrastructure acts as a bottleneck to future growth

Regulatory initiatives

The government has set up National Automotive Testing and R&D Infrastructure Project (NATRiP) at a total cost of US$ 388.5 million to enable the industry to meet global standards.

Source:
Industry report prepared by Ibef and ASA.
Industry report prepared by Automotive Component Industry
Industry report prepared by Wipro

Key expectations

Industry expectations

- Incentivise replacement of vehicles, which were registered before the year 2000 when the first emission norms were introduced
- Government needs to support the sector and consider the roadmap for GST implementation
- Economic reforms such as long term excise duty stability, lowering of interest rates and a uniform tax structure, which can hopefully bring a sustained growth in the automobile industry
- In connection with new plant and machinery, the condition of put to use for 180 days restricting the initial depreciation to 10% should be removed in order to further boost investment
- Depreciation rate for motor cars, multi utility vehicles and two wheelers, other than those used in the business of hire, irrespective of the period of addition should be raised to 25% from 15% (bringing down the useful life as 10 years in place of present estimate of 19 years approximately)
- Rate of tax on royalty and fees for technical services to non-residents should be restored back to 10% to have consistency. Alternatively, the rate of tax should be maximum 20% in line with Section 206AA of the Act
- GST should be introduced across all states and the draft modalities & procedures should be shared in advance. The GST should subsume all indirect and other taxes, including Road Tax, R&D cess, Octroi and road tax to prevent cascading effect
- Excise duty and customs duty concessions on identified parts of hybrid/ electric vehicle parts should be extended for a longer period instead of March 2015
- Excise duty on all vehicles with seating capacity of 10–13 persons should attract the same rate as buses
- 1% national calamity contingent duty on vehicles should be withdrawn
- Concessional excise duty structure / equivalent GST rate of 10% should be applicable on small passenger vehicles, multi utility vehicles, two wheelers, three wheelers and commercial vehicles
- For new plant and machinery, the condition of put to use for 180 days restricting the initial depreciation to 10% should be removed in order to further boost investment
- Depreciation rate for motor cars, multi utility vehicles and two wheelers, other than those used in the business of hire, irrespective of the period of addition should be raised to 25% from 15% (bringing down the useful life as 10 years in place of present estimate of 19 years approx.)

Key expectations

Industry expectations

- Rate of tax on royalty and fees for technical services to non-residents should be restored back to 10% to have consistency. Alternatively, the rate of tax should be maximum 20% in line with Section 206AA of the Act
- Cenvat Credit Rules may be amended to allow 100% Cenvat credit on capital goods in the year
- Rate of excise duty may be reduced to 10% from 12% for all components used in the manufacture of vehicles
- Elimination of customs duty on all alloy steel, aluminum alloy and secondary aluminum alloy items to nil
- Reduction in import duty on Butyl Acrylate used in auto sector
- Reduction in excise duty on plastic/ polymers used in automobiles
- Definition of capital goods to include all kinds of motor vehicles and CENVAT credit of the same should be eligible
- Time limit of 6 months for availing Cenvat credit should be withdrawn

Source: *Industry report prepared by SIAM and ACMA*

Budget impact – Our view

- “While some of the expectations like reverting back to the excise duty pre December 2014 have apparently not been heard and addressed, reduction in customs duty for input materials would make manufacturing competitive. One would have expected a lot more than only extending for a short period the exemption in customs duty for hybrid vehicles. Planned spend on infrastructure would be an enabler of growth for the auto and manufacturing industry, if executed properly.”

Budget announcements - Key policy initiatives

Key policies and announcements

- An expert committee to examine possibility and prepare a draft legislation where multiple prior permissions can be replaced by a pre-existing regulatory mechanism to facilitate India becoming an investment destination
- Tax free infrastructure bonds for the projects in the rail, road and irrigation sectors; PPP mode of infrastructure development to be revisited and revitalised
- **National Investment and Infrastructure Fund (NIIF)** to be established with an annual flow of Rs 20,000 crore
- Proposal to create Micro Units Development Refinance Agency (MUDRA) Bank, with a corpus of Rs 20,000 crore, and to facilitate credit guarantee corpus of Rs 3,000 crore
- Set up a **trade receivables discounting system (TReDS):** An electronic platform to facilitate financing of trade receivables of MSMEs

Budget announcements - Direct tax proposals

Income tax rates

- Surcharge for domestic companies increased by 2% as under:
  - Surcharge @ 7% (if the taxable income > Rs 1 crore but < Rs 10 crore)
  - Surcharge @ 12% (if the taxable income > Rs 10 crore)
- Finance Minister proposes to phase out exemptions and bring corresponding reduction in corporate tax rate from 30% to 25% over the next four years
- Wealth tax abolished. Shortfall on account of wealth tax to be met through levy of additional surcharge of 2% on the super-rich that have taxable income over Rs 1 crore

Additional depreciation

Grant of 50% additional depreciation in subsequent year

For qualified assets where additional depreciation is allowed, it is proposed, that in cases where only 50% depreciation has been claimed in the first year on account of the assets being used for less than 180 days, the balance 50% of additional deprecation would be allowed in the subsequent year.

Additional depreciation for new manufacturing units in Andhra Pradesh or Telangana

New manufacturing undertakings set up after 1 April 2015 in any notified backward area in Andhra Pradesh or Telangana, which acquire and install new machinery or plant during the period 1 April 2015 to 31 March 2020, shall be entitled to additional depreciation for @ 35% against 20% allowed currently.

Budget announcements - Direct tax proposals

Royalty and fess for technical services

- Tax rate on royalty and fee for technical service payable to non residents has been reduced from 25% to 10%

GAAR deferral

- General Anti Avoidance Rule (GAAR) deferred by two years, to come into effect from 1 April 2017. Further, it shall also apply to investments made on or after 1 April 2017

Withholding tax

- Currently, as per Section 194C, tax withholding is not required on payments to contractor engaged in plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number (PAN) to the person making the payment. The exemption is now restricted to contractors owning ten or less goods carriages at any time during the relevant year - w.e.f. 1 June 2015
- Any amount paid to non-resident shall require the payer to provide information in the prescribed format to the revenue authorities, irrespective of whether such payment constitutes income in the hands of the payee or not

Budget announcements - Direct tax proposals

Deduction in respect of 'additional wages'

- 30% deduction in respect of 'additional wages' currently available to Indian companies now extended to all tax payers – corporate or non corporate
- Threshold for computing 'additional wages' reduced from 100 new regular workmen to 50
- No deduction for 'additional wages' where manufacturing factory is acquired from any other person or as a result of business re-organisation

Additional investment allowance for new manufacturing units in Andhra Pradesh or Telangana

- New manufacturing undertaking set up after 01 April, 2015 in any notified backward area in Andhra Pradesh or Telangana, which acquire and install new machinery or plant (as defined) during the period 1 April 2015 to 31 March 2020 shall be entitled to deduction of 15% of the cost of such machinery or plant in the year of installation
- Allowance shall be in addition to investment allowance granted under Section 32AC
- Sale or transfer of such assets before five years from the date of installation shall trigger taxation of the allowance availed earlier – Not applicable in the case of amalgamation, demerger or prescribed re-organisation

Budget announcements - Indirect tax proposals

Budget amendments

Customs

- Change in effective basic customs duty on import of motor vehicles for the transport of ten or more person and motor vehicles for transport as follows:
  - In case of import of Completely Knocked Down (CKD) Units: 10%
  - On import in any form other than CKD: 20%
- Reduction in basic customs duty on butyl acrylate (chemical used for paint manufacturing) from 7.5% to 5%
- Benefit of basic customs duty exemption @ 6% and SAD exemption on specified goods for use in the manufacture of electrically operated vehicles and hybrid motor vehicles extended till 31 March 2016

Excise

- Reduction in excise duty on chassis for ambulances from 24% to 12.5%
- Education cess and secondary & higher education cess leviable on excisable goods fully exempted
- Excise duty rate increased to 12.5% from 12.36% (Education cess and SHEC abolished)
- Concessional excise duty @ 6% benefit on specified goods for use in the manufacture of electrically operated vehicles and hybrid motor vehicles extended up to 31.03.2016

Budget announcements - Indirect tax proposals

Budget amendments

Customs

- General effective customs duty rate has been increased from 28.85% to 29.44%
- Penalty provisions rationalised in favour of taxpayer, effective from date of enactment of Finance Bill, 2015; unless otherwise specified
- Prosecution provisions of Section 132 of the Customs Act, 1962 relating to giving false declarations, false documents etc. incorporated as an offence in Part B of the Money Laundering Act, effective from date of enactment of Finance Bill, 2015; unless otherwise specified

Service tax

Effective from a date to be notified after enactment of Finance Bill, 2015:

- Rate increased from 12.36% (inclusive of all cess) to 14% (subsuming all cess)
- Additional 2% proposed to be charged on taxable service value in the form of Swachh Bharat Cess (SBC)

Effective from 1 April 2015, unless otherwise specified:

- The rate of abatement available in relation to GTA services, transport of good by vessel and transport of passengers by air is as follows:

Particulars	Pre Budget	Post Budget
Transport of goods by road	75%	70%
Transport of goods in a vessel	60%	70%
Transport of passenger by air - Economy class - Other than economy class	 60% 60%	 60% 40%

Budget announcements - Indirect tax proposals

Budget amendments

Service tax

- Digitally signed invoice, bills, challans or consignment notes given legal status
- Service tax records may be maintained in electronic form with digital signature on each page
- Class of persons eligible to approach the advance ruling authority now includes specified resident partnership firms as defined under the service tax law
- Definition of 'consideration' expanded to include reimbursements charged in course of providing taxable service
- Where service tax disclosed as payable in returns but amounts not paid, coercive measures of recovery could be initiated without issuing demand notice
- Specific provisions introduced to facilitate smooth transition of pending matters from previous penalty regime to above proposed penalty regime

- Penalty provisions rationalised in favour of taxpayer in the following manner:

Event	Amendment
Notice to recover service tax not paid/ short paid	If disputed service tax paid within 30 days from receipt of Notice
(a) in cases not involving fraud, etc	(a) No penalty to be charged (If disputed service tax paid after 30 days in cases not involving fraud, penalty reduced from 50% to 10%)
(b) in cases involving fraud, etc	(b) penalty reduced from 100% to 15% in cases where fraud involved
Order passed for recovery of service tax	If service tax paid within 30 days of the Order, penalty reduced to 25% of amount demanded in said Order

Budget announcements - Indirect tax proposals

Budget amendments

CENVAT Credit Rules, 2004

(Effective from 1 March 2015; unless otherwise specified)

- Period of availing CENVAT credit on inputs and input services extended from six months to one year from date of invoice / challan or other specified documents
- CENVAT credit of service tax paid under domestic reverse charge now allowed to claimant, without linking it to the payment of services to the input service provider (effective from 1 April 2015)
- Effective from 1 April 2015, CENVAT credit wrongly taken (i.e. availed) or utilised by manufacturer or output service provider to attract recovery proceedings under Central Excise Act and service tax law respectively with similar penalties
- CENVAT credit on inputs and capital goods allowed to manufacturer or output service provider, as the case may be, even in case of direct receipt of such goods in the premises of the job worker on the direction of principal manufacturer/ output service provider
- CENVAT credit allowed to principal manufacturer on inputs, whether as such or after partial processing, sent from premises of one job worker to another job worker
- The time limit for return of capital goods from premises of a job worker to principal manufacturer/ output service provider increased from six months to two years

Budget announcements - Indirect tax proposals

Budget amendments

Goods & Services Tax (GST)

- Central government working closely with Empowered Committee of State Finance Ministers (Empowered Committee) to ensure implementation of GST in India meets the self-imposed timeline of 1 April 2016
- To enable GST introduction, Constitution Amendment Bill tabled in Lok Sabha (Lower House of Parliament) in winter session; expecting ground level consensus built through Empowered Committee would create political consensus to move the Bill through both Houses of Parliament shortly
- Finance Minister reiterates that GST introduction is equal to introducing "state of the art" indirect tax system in India, through Centre-State joint efforts
- However, GST Roadmap (see table alongside) indicates that much work needs to be done
- **Given above limitations, GST by 1 April 2016 still seems optimistic**

GST Roadmap/ To-do list	
Centre-State consensus on GST structure for India (dual-GST)	✓
State revenue loss compensation formula agreed	✓
Constitution Amendment Bill to drive agreed structure tabled before Parliament	✓
Constitution amended to give effect to GST structure	?
Model GST Bill (Central GST and State GST) released for discussion	?
Amended GST Bills enacted in respective legislatures	?
Model GST Rules (For Place of Supply, Administration, etc.) released	?
GST Rules and Regulations notified for implementing GST in India	?

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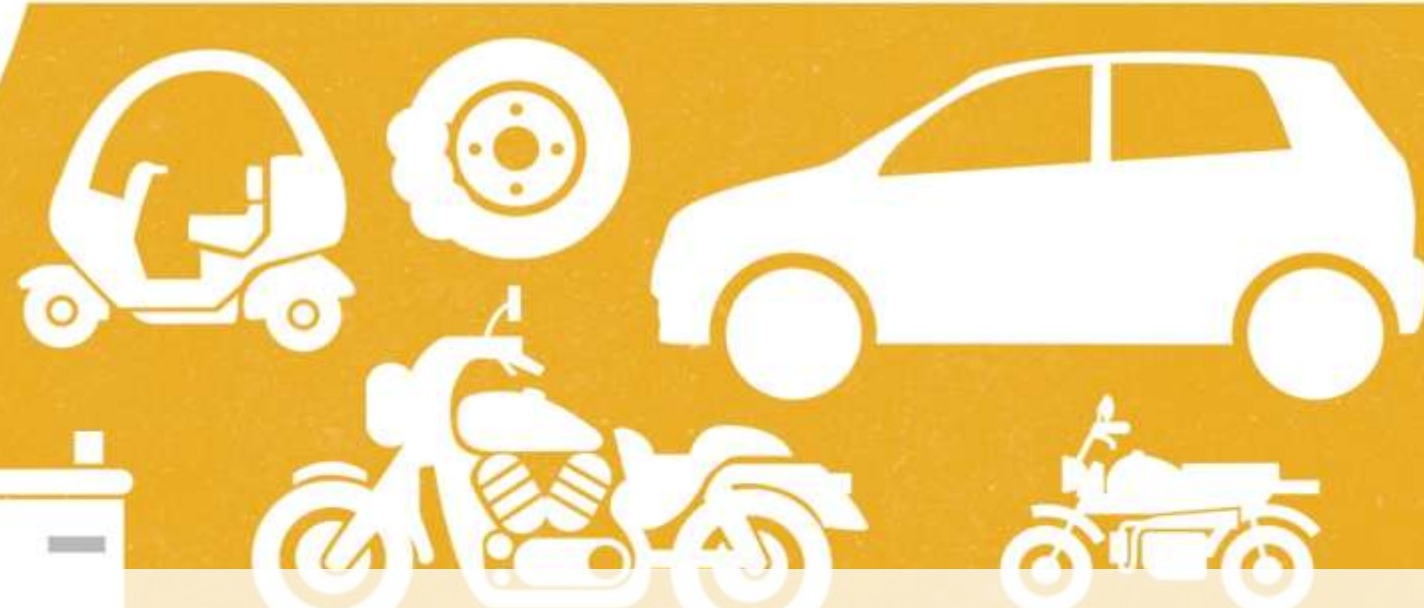

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