Grant Thornton

# UnionBudget 2009-10

## Infrastructure & Real Estate Industry

### A run Up

Investment in infrastructure, a major contributor to the Gross Domestic Product (GDP), has been the buzz word of Indian policy making with infrastructure development assuming paramount importance in the economic growth of the country.

India's core infrastructure industries include power, road, telecommunication, steel, cement, crude oil, petroleum and coal. It is also one of the largest employers of semi-skilled manpower.

As per the Government estimates, India needs US$500 billion of investment into its roads, railways, ports and airports in the next 5–7 years. About $150 billion would come from the private sector, necessitating urgent measures to facilitate Public Private Partnership (PPP) investments by providing fiscal and non-fiscal incentives, especially at a time of risk aversion and tightening access to credit.

On the other hand, real estate has been amongst the most severely affected sectors by the global recession. Over the past 12 to 18 months, the sector has been facing an incessant decline in demand, followed by a consequential fall in prices.

The sector, being fairly restricted for foreign investments, has become infamous for cash-strapped and undeveloped projects. The other key issues that confront the Indian real estate industry include:

- Low access to finance (for both suppliers and buyers) and low confidence of buyers
- Limited Floor Space Index (FSI)
- High customs and excise duty on raw materials for construction
- Phasing out of income-tax benefits for developers & lack of incentives for developing low-priced housing

In the end, there is a need to consider these sectors favorably, since they are clear triggers to economic growth and hence timely intervention by the Government in the form of providing appropriate stimulus is the need of the day

# Key Expectations

Key expectations of the Infrastructure sector:

- PPP model to be encouraged and made more efficient
- Increased budgetary allocation and investments in basic infrastructure
- Establishment of an effective regulatory and monitoring agency for the infrastructure sector
- Stable policy framework to attract private capital, both domestic and foreign
- Easing of land acquisition norms
- Liberalized External Commercial Borrowings (ECB) guidelines and opening up of routes to access cheaper long term finances
- Treatment of infrastructure holding companies as a separate class of NBFCs and exempting them from the restrictions imposed on usual NBFCs
- Allowing pension funds to invest about 10-15% of their funds in infrastructure bonds
- Removal of Fringe Benefit Tax (FBT)
- Customs duty to be abolished on inputs used by equipment manufacturer for projects financed by international agencies
- Exemption from excise duty for goods manufactured onsite for mega infrastructure projects and imports for mega power plant projects
- Exemption from Customs duty on capital goods brought back into India after execution of construction work outside India
- Customs duty on coal and pet coke be abolished
- Fly ash be supplied by power companies at no cost to cement firms
- Abolition of service tax on construction activity
- Inclusion of cement in 'declared goods' under the Central Sales Tax Act, 1956

Specific expectations of the power industry:

- Extension of tax holiday for power sector for another 5 years
- Excise duty exemption be made available to power transmission companies
- Excise duty exemptions in power equipment should be reconsidered
- No free electricity to certain economic groups as practiced in several States
- Link central assistance to States to reducing T&D losses
- Harmonizing definitions in different tax laws recognizing the peculiarities of this sector, especially with respect to ownership of assets and power facilities

# Key Expectations

Specific expectations of the Mineral Oil and Gas industry:

- Tax holiday on the production of natural gas to be made in line with crude oil and for city gas distribution
- Tax holiday on the production of crude oil in a block of 10 to 15 years
- Accelerated rate of depreciation on equipment used for exploration.
- Removal of service tax on exploration activity
- Deregulation of fuel prices

Specific expectations of Real Estate industry:

- Extending access to ECB scheme to the entire real estate sector of the country, to provide significant relief to cash starved sector
- The current limit of Foreign Direct Investment (FDI) should be enhanced so as to provide an access to international funds
- The FSI should be enhanced so as to cater with the overall demand
- Commercial bank lending rates to real estate developers should be lowered
- Customs duty and excise duty should be reduced on the raw materials procured locally
- Uniform stamp duty should be enforced and reduced to 2% across all states. Higher transparency should be provided vis-à-vis land records
- Reintroduction of income tax holiday under section 80IB for housing. Also, extension of tax holiday under section 80ID to 10 years from the existing limit of 5 years
- Incentives for the construction of affordable housing
- Availability of affordable housing loans, with rate of interest at 5–6 % approx. for loans below Rs 5 lakhs
- Increase in interest deduction under the Income Tax Provisions to Rs3 lakhs from current limit of Rs1.5 lakhs
- Increase the basic exemption limit under Wealth Tax Provisions to Rs50 lakhs against existing limit of Rs15 lakhs
- Introduction of a real estate regulator to enhance higher levels of transparency. This would infuse greater confidence both amongst investors and end-users
- Clarity on Real Estate Mutual Funds (REMFs) & Real Estate Investment Trusts (REITs) in terms of valuations, tax status, etc.

# Key Policy Initiatives

- The Finance Minister reinstated the importance of the infrastructure sector by increasing the infrastructure investment to more than 9% of the Gross Domestic Product (GDP) by 2014
- 'Takeout financing' scheme to facilitate incremental lending to infrastructure projects to be evolved
- India Infrastructure Finance Company Limited (IIFCL) to refinance 60% of commercial bank loans for Public Private Partnerships (PPP) projects in critical sectors
- Allocation to the National Highways Authority of India (NHAI) for the National Highways Development Programme (NHDP) stepped up by 23% over the 2008-09
- Allocation for Railways also increased to Rs.15,800 crores from Rs.10,800 crores made in the Interim Budget for 2009-10
- Allocation for the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) scheme stepped up by 87 % to Rs.12,887 crores
- Enhanced allocation of Rs.3,973 crores for housing and provision of basic amenities to urban poor
- Provision of a new scheme -- Rajiv Awas Yojana (RAY) proposed intended to make the country slum free in the five year period
- Provision for Brihan Mumbai Storm Water Drainage Project increased from Rs.200 crores to Rs.500 crores during the current year
- Blueprint for long distance gas highway leading to National Gas Grid proposed to be developed
- The allocation to the Accelerated Power Development and Reform Programme is proposed to be increased by 160% to Rs.2,080 crores
- The allocations to Bharat Nirman is proposed to be enhanced by 45%
- The allocation to Pradhan Mantri Gram Sadak Yojana (PMGSY) is proposed to be enhanced by 59% to Rs.12,000 crores
- Proposal to allocate Rs.7,000 crores allocated to Rajiv Gandhi Grameen Viduytikaran Yojana (an increase of 27%)
- A new scheme, Pradhan Mantri Adarsh Gram Yojana for integrated development of 1,000 villages on a pilot basis with an allocation of Rs.1,000 crores introduced
- The allocation for the Indira Awas Yojana (IAY) is proposed to be increased by 63% to Rs.8,800 crores
- Rs.2,000 crores to be allocated for Rural Housing Fund in the National Housing Bank (NHB) to boost the refinance operations in the rural housing sector
- Additional Rs.1,000 crores over the Interim Budget allocation, provided for Accelerated Irrigation Benefit Programme
- Allocation for the Rashtriya Krishi Vikas Yojna stepped up by 30%

# Direct Tax Proposals

- Corporate tax rate (including surcharge and cess) unchanged
- **Minimum Alternate Tax (MAT)**
  - MAT rate increased to 15% from 10%
  - MAT credit allowed to be carried forward and set off up to 10 years
  - "Book profit" to be increased by provision in diminution in value of any asset
- FBT has been proposed to be abolished. Consequently, fringe benefits provided to employee are proposed to be taxed as perquisites
- TDS on payment for work done and certain services rendered now rationalized – 2% across all payments made to persons other than individual or HUF, and 1% from payments to individuals and HUFs.
- **Units claiming tax benefit under section 10A [other than units in Special Economic Zone (SEZ)] and 10B:**
  - Terminal date has been proposed to be extended from Assessment Year (AY) 2010-11 to AY 2011 -12
  - Tax benefit to be allowed only if the same is claimed in the return of income (amendment proposed to be effective retrospectively from AY 2003-04)
- Clarification provided in respect of calculation of tax benefit for SEZ units under section 10AA -- tax benefit to be computed taking "total turnover of the **undertaking**" as the denominator instead of "total turnover of the business of the assessee"
- Weighted deduction for in-house R&D has been extended to companies engaged in business manufacture or production of an article or thing except those specified in 11th Schedule of the Act

## Specific to the power sector

- Terminal benefit under section 80IA has been proposed to be extended as under:

| Undertaking engaged in: | Existing terminal date | Proposed terminal date |
|---|---|---|
| **Generation and distribution of power** | 31 March 2010 | 31 March 2011 |
| **Transmission and distribution by laying a network of new transmission or distribution lines** | 31 March 2010 | 31 March 2011 |
| **Substantial renovation and modernization of existing network of transmission and distribution lines** | 31 March 2010 | 31 March 2011 |
| **Undertaking owned by Indian company and set for reconstruction or revival of a power generating plant which begins to generate or transmit or distribute power** | 31 March 2008 | 31 March 2011* |

** Amendment proposed to come into effect retrospectively from AY 2008-09*

# Direct Tax Proposals

## Specific to cold chains and natural gas

- **Investment-linked tax incentives:**
  – Deduction for capital expenditure (other than that for land, goodwill and financial instrument) is proposed to be available to the following businesses under newly inserted section 35AD:

| Undertaking engaged in | Proposed Commencement date |
|---|---|
| **Setting up and operating cold chain facility for certain specified products** | On or after 1 April 2009 |
| **Setting up and operating warehousing facility for storage of agricultural produce** | On or after 1 April 2009 |
| **Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution including storage facilities being integral part of such network** | On or after 1 April 2007 |

  – Consequential changes:
    - Actual cost of any capital asset will be taken as NIL, where a deduction in relation to such asset has been allowed or is allowable under section 35AD
    - Amount received on demolition, destruction, transfer, etc of any capital asset to be taxed as business income where whole of expenditure on such capital asset has been allowed as deduction under section 35AD
    - For the purposes of computing "net worth" in a slump sale, it is proposed that the capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, the aggregate value of such asset to be as nil
    - Loss in respect of businesses referred to in section 35AD to be set off against loss from any other business specified in that section

# Direct Tax Proposals

### Specific to mineral oil and gas industry

- The terminal date of deduction for undertaking in private sector engaged in refining of mineral oil proposed to be extended till 31 March 2012
- Tax deduction proposed to be made available also to undertakings engaged in commercial production of **natural gas** in blocks licensed under the VIII Round of bidding for award of exploration contracts under the New Exploration Licensing Policy announced by the Government of India and begins commercial production of natural gas on or after the 01 April 2009
- All blocks licensed under a single contract, shall be treated as a single "undertaking" (amendment proposed to be effective retrospectively from AY 2000-01)

### Specific to Real Estate industry

- In section 80-IB(10), two additional conditions are introduced from 01 April 2010 for claiming tax benefit :
  - not more than one residential unit in the housing project is allotted to any person not being an individual; and
  - in a case where a residential unit in the housing project is allotted to an individual, no other residential unit in such housing project is allotted to any of the following persons, namely:
    - the spouse or the minor children of such individual;
    - the Hindu undivided family in which such individual is the karta;
    - any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta

- TDS rates on rental of land and building have been reduced from 15%/20% to 10%.

# Indirect Tax Proposals

- Service tax composition scheme @ 4% to be available only to such works contract where the gross value of works contract includes the value of all goods used in execution of works contract whether received free of cost or for consideration under any other contract
- Exemption from  Customs Duty on concrete batching plants (50 c/hr.) withdrawn and duty imposed at 7.5%.
- Exemption from  excise duty on onsite manufacturing of goods falling under Chapter 68, i.e. stone, plaster, cement, asbestos, mica, etc
- Manufacturer of dutiable and exempted goods, not maintaining separate accounts, liable to pay excise duty @ 5% of the price of exempted goods to avail cenvat credit.
- 'Input' not to include cement, angles, channels, CTD/TMT bars etc used for construction of factory shed or structure for capital goods.
- Cenvat credit to be reversed on inputs and capital goods written off before being put to use.

# Expert Viewpoint

The budget proposals are a mixed bag as far as the Real Estate and Infrastructure sectors are concerned.

- The real estate players are heaving a sigh of relief that no retrospective amendment is proposed to restore service tax on commercial renting of immovable property
- Various policy initiatives announced by the FM, such as sizeable allocations to National Highways Development Programme, Railways, Brihan Mumbai Storm Water Drainage Project, and the Pradhan Mantri Adarsh Gram Yojana for integrated development of 1000 villages, and Gram Sadak Yojana give cause for hope. Besides, the proposal for IIFCL to refinance 60% of commercial bank loans for Public Private Partnerships projects in critical sectors is heart-warming
- Exemption from excise duty on onsite manufacture of goods, will provide great procedural and financial relief
- The anticipated relief from tax with respect to investments in infrastructure companies did not see the light of day
- From a real estate perspective, there has been no policy measures nor any tax relief announced that could alleviate the sector from the crisis it is currently going through. Expectations for initiatives to spur demand and availability of funds for this sector has unfortunately not been addressed
- However, change in valuation provisions of Works Contract could have extensive impact on tax planning by real estate companies

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