Grant Thornton

UnionBudget 2009-10

Auto Sector

A Run-Up

Over the last few years, India has been recognized as one of the preferred locations for automobile manufacturing as well as for sourcing auto components and auto R&D (Research & Development). At the same time, Indian automotive and component manufacturers have responded strongly to competition and further catalysed their contribution to the economic growth of the country. Indian auto sector has witnessed a Compounded Annual Growth Rate (CAGR) of 11.5% per annum over the last 5 years. In 2006-07, this sector contributed 5% to the Gross Domestic Product (GDP) of India and this is expected to increase to 10% by 2016.

Despite the global recession and the near demise of some major global auto players, Indian auto industry recorded a modest growth of 3% in the previous fiscal year (more or less the same as the previous year). However, the Indian auto industry is still reeling under the pressure in multiple ways:

- Contraction in global demand for automobiles in general due to the slowdown, affecting exports of Indian auto manufacturers
- Loss/reduction of business for the Indian auto component industry due to several global auto players downsizing their operations, conditions for revival of some major US auto players
- Consequent cutback in auto R&D activities, slowing down the investment in this sector

Perhaps, the only positive indicator for the Indian auto industry was the performance of the 2-wheeler industry which has witnessed growth. Regardless of the slowdown, the prospects of growth for the Indian auto industry are professed to be high, especially on the back of domestic demand. This would have an impact both on the home grown auto companies as well as global players enhancing their presence for an increased market share. It is now for the Government of India to respond proactively and take measures to enable the auto sector to carve out a plan to address the slowdown, enable revival and accelerate the growth to succeed in the global arena.

Key Expectations

The Indian auto industry had the following key expectations from the forthcoming budget:

- No increase in excise duty
- Abolition of additional duty on passenger vehicles and bigger cars
- Review of the Free Trade Agreements (FTAs) which provides for lower customs duty
- Reduction in customs duty on rubber and other raw materials
- Continuance of tax holiday for Export Oriented Units (EOUs)
- Deductions for profits on exports for small and medium sector which are non-EOUs
- Creation of special auto-component parks with direct and indirect tax benefits
- Steps (including extension of tax benefit, exemption from import duty on capital goods required for R&D, abolition of service tax on R&D, etc) to attract investment in R&D
- Extension of higher depreciation benefit for new commercial vehicles beyond September 2009
- Increase in tax depreciation from 15% to 25%
- Incentives for promotion/ conversion to cleaner technology and alternative fuel like Compressed Natural Gas (CNG) and Liquefied Petroleum Gas (LPG)
- Higher outlay on road development and modernisation programmes
- Implementation of GST (Goods & Service Tax) on the proposed date 01 April 2010
- Reduction in the rate of Central Sales Tax (CST) from 2% to 1%
- No MRP based assessment for Earthmoving machinery or parts thereof
- Abolish the Specific Excise duty levied over & above ad-valorem Excised duty
- Reduction in interest rate on auto loans to boost demand

Key Policy Initiatives

- Some of the Key Policy Initiatives as relevant to the auto sector have been:
  - Reinstating the importance of the infrastructure industry, the Finance Minister shared his vision of increasing investment in this sector to more than 9% of the GDP by 2014.
  - As part of this vision, the outlay and allocations made towards road development and modernization programs include:
    - Allocation to National Highways Authority of India for the National Highways Development Program (NHDP), stepped up by 23%
    - The allocation to Pradhan Mantri Gram Sadak Yojana (PMGSY) is proposed to be enhanced by 59% to Rs. 12,000 crores
    - 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

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 (in place of the existing 7 years)
  - "Book profit" to be increased by provision in diminution in value of any asset

- Fringe Benefit Tax (FBT) has been proposed to be abolished. Consequently, fringe benefits provided to employee are proposed to be taxed as perquisites

- **Units claiming tax benefit under section 10A [other than units in SEZ (Special Economic Zone)] 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

Indirect Tax Proposals

- Reduction in excise duty rate from 20% + Rs.20,000 per unit to 20% + Rs.15,000 per unit on motor vehicles having engine capacity exceeding 1999cc
- Reduction in excise duty rate from 20% to 8% on petrol driven motor vehicles for transport of goods except dumpers of tariff item 8704.10.90
- Reduction in excise duty rate on chassis of such petrol driven vehicles from 20% + Rs.10,000 per chassis to 8% + Rs.10,000 per chassis
- No cenvat credit would be allowed on goods, e.g Cement, Angles, Channels, TMT/CTD bars etc. used for installation of machinery, construction of factory shed
- Reversal of cenvat credit on any inputs or capital goods written off from book of accounts before being put to use
- The Finance Minister reiterated the commitment of introduction of dual GST (Union & State level) by 01 April 2010.

Expert Viewpoint

- In the Key Policy Initiatives announced by the FM, there is an increased outlay by 23% for the NHDP and by 59% for the PMGSY
  - This would be beneficial for the sector
- A new scheme, the Pradhan Mantri Adarsh Gram Yojana for an integrated development of 1,000 villages has been introduced on a pilot basis with an allocation of Rs. 1,000 crores
  - Integrated development would involve utilization of the outlay for creating better road connectivity also. This will indirectly impact the auto sector and is a welcome initiative
- There have been no significant announcements or amendments made for the sector in the Direct Tax Proposals either (a) by way of boosting demand for this sector or (b) any specific direct tax benefit for companies engaged in this sector, except for:
  - Extension of tax holiday under 10B - however this is only for 1 year, not quite significant to help the industry get back to its feet
  - Extension of R&D benefit to manufacturing companies does not change anything which the auto sector was already enjoying prior to this amendment
- On the indirect tax side, there were no major expectations after reduction of excise duty on 24 February 2009
- Reduction of excise duty on petrol driven vehicle for transportation of goods is a welcome move. However, expectation of industry regarding abolition of specific duty on cars above 1500 CC has not been met, though the same has been rationalised
- Impact of the introduction of GST from 01 April 2010 would need to be evaluated once the roadmap for its introduction is laid out

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