February 2011

Budget 2011 — Infra impact

Economic survey 2010-11:

Highlights

The Indian economy has recovered rapidly from the aftermath of the global economic slowdown as is evident from the accelerating GDP growth (8% in FY10, 8.6% expected in FY11 and 9% forecasted for FY12). The agriculture sector rebounded in FY11, registering a growth of 5.4%. The industry and services witnessed growth of 8.1% and 9.6%, respectively. The savings rate has increased to 33.7% and investment rates have risen to 36.5%.

The survey presents an optimistic outlook about the long-term prospects of the economy, supported by a momentum in savings and investment rates and India's "demographic dividend." However, the survey cautions that factors such as any sharp deterioration in weather, inconsistent hike in global energy prices, slowdown in key industrialized nations could affect the expected growth.

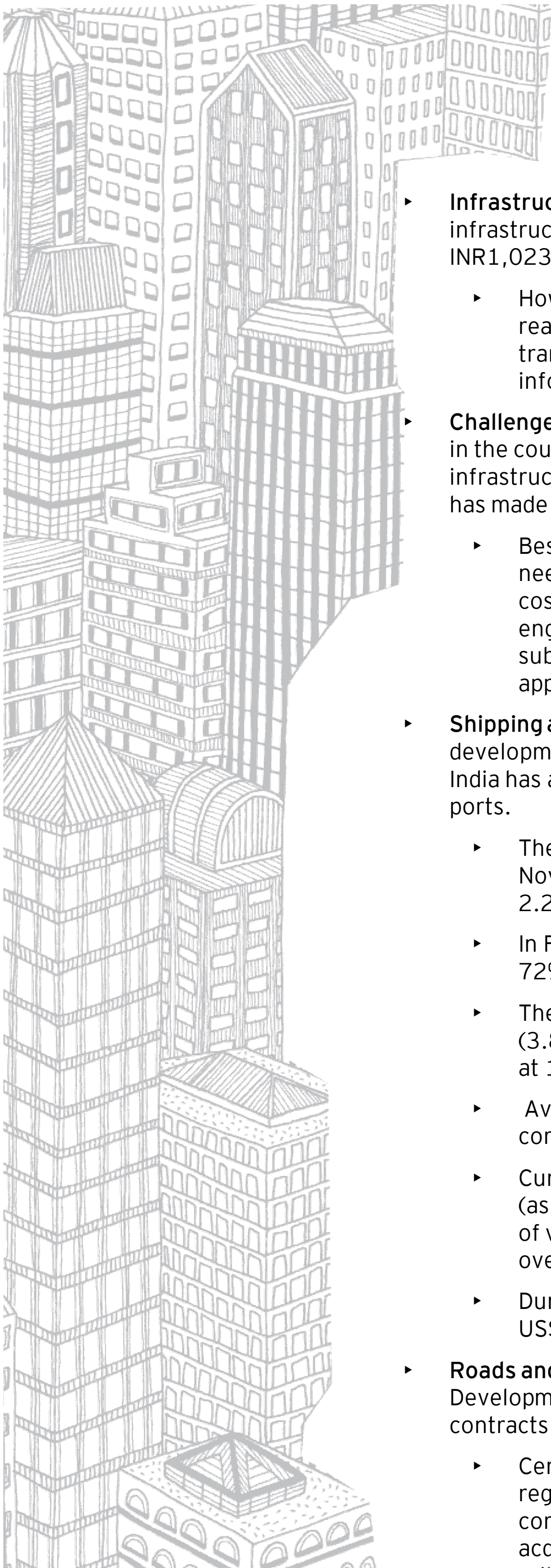
Meanwhile, the infrastructure sector witnessed a mixed-bag of performance in FY11 — while, some sub-sectors such as telecom and rural electrification have been on or above targets, capacity additions in some others like power and national highways has been less than targeted.

The following are some of the highlights related to the infrastructure sector in the survey:

- In FY11, the Planning Commission revised its estimates of total investment in infrastructure during the Eleventh Five Year Plan to INR20,542 billion. Infrastructure investment as a percentage of GDP is expected to increase from 7.18% in FY09 to 8.37% in FY12. Contribution of the private sector in the first two years of the Plan has been above the targeted 30%.
- The overtime project delays for projects costing INR1.5 billion or more has been rising gradually. As on October 2010, out of 559 projects being monitored, 14 were ahead of schedule, 117 were on schedule and 293 were delayed. Most of the projects being delayed are roads, power, railways, petroleum, telecom, coal and steel.

Ernst & Young

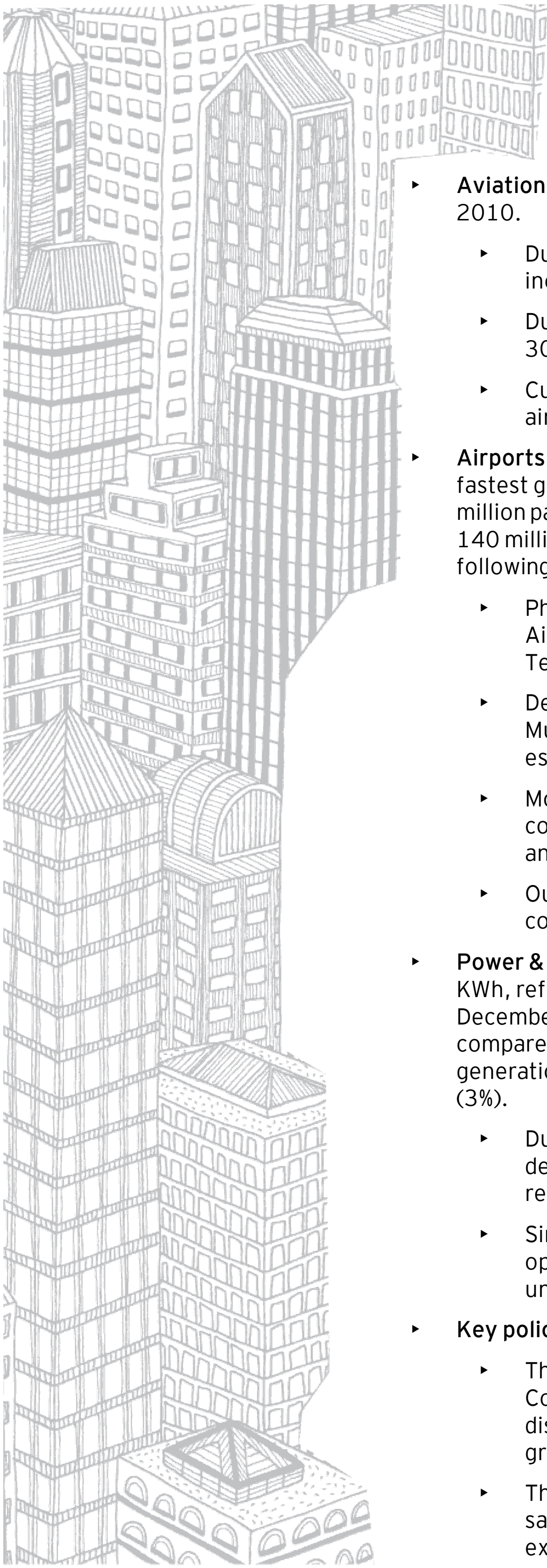
Quality In Everything We Do



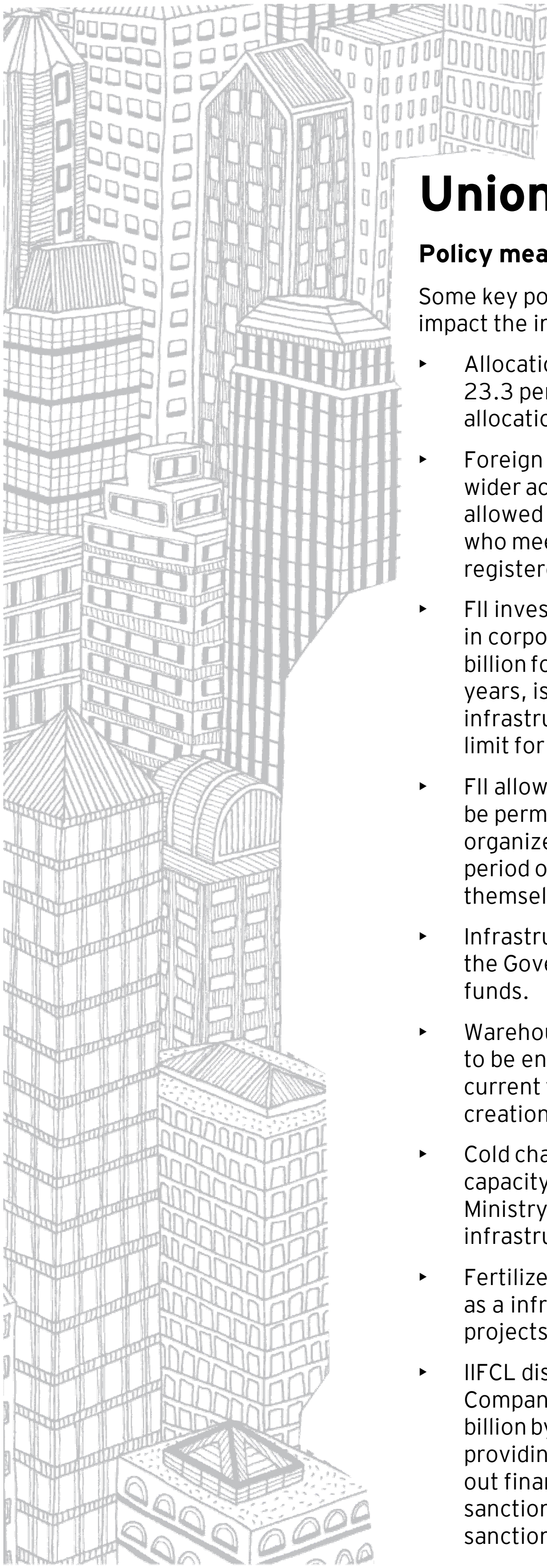
- **Infrastructure financing**: The incremental flow of bank credit to infrastructure sector between April and November 2010 has increased by INR1,023 billion, reflecting a y-o-y growth of 59%.
  - However, FDI inflows during April-November 2010 declined 27% to reach US$3.3 billion. While FDI in petroleum, natural gas and air transport increased, FDI declined in power, telecommunications, and information and broadcasting sectors.
- **Challenges faced by the sector:** In order to reduce the infrastructure deficit in the country, certain challenges need to be overcome. Financing of infrastructure projects is a key challenge and the Deepak Parikh Committee has made some recommendations to overcome this challenge.
  - Besides financial challenges, certain non-financial challenges also need to be addressed. Some of these include: 1) avoiding time and cost overruns; 2) tendering of unviable projects 3) bad quality of engineering and planning at DPR stage; 4) lack of standardized and sub-optimal contacts and 5) land acquisition delays and slow approval processes.
- **Shipping and ports:** Ports play an imperative role in the overall economic development of the country and act as the gateway for international trade. India has a long coastline with 13 major ports and around 200 non-major ports.
  - The cargo handled at major ports increased only by 0.8% during April–November 2010. During FY10, the growth was 5.7% compared with 2.2% in FY09.
  - In FY10, major ports handled 67% of the total cargo, compared with 72% in FY09.
  - The average turnaround time at major ports was 4.38 days in FY10 (3.87 days in FY09) and average pre-Berthing time has been recorded at 11.67 hours during FY10 (9.55 hours in FY09).
  - Average output per ship-berth-day was 10,168 tonnes in FY10, as compared with 10,473 tonnes in FY09.
  - Currently, there are 47 PPP projects being executed in ports sector (as compared with 43 projects in the corresponding period). In terms of value, projects being executed are worth INR697.1 billion (up 5% over last year).
  - During April–November 2010, FDI in ports declined significantly to US$10.9 million from US$65.4 million during April–November 2009.
- **Roads and highways:** Between April–November 2010, National Highway Development Programme (NHDP) built 1,007 km of highways and awarded contracts for a total length of 3,780 km.
  - Certain initiatives taken to increase the progress of NHDP include regular monitoring of contracts and projects, setting up of committees and regional offices to resolve problems related to land acquisition, utility shifting, environmental approvals and clearance of railway over bridges.

- The National Highway Authority of India (NHAI) revised its strategy for implementation of NHDP. This includes work plans (I and II) for allocating around 12,000 km each during FY10 and FY11. In Work Plan I 73 projects of 6,426 km have been awarded and bids for nine projects are at various stages. Work Plan II includes one project of 170 km and five upcoming projects.
- To meet the financial requirements for NHDP, in FY10 NHAI took external assistance of INR3.4 billion (INR18.9 billion last year), and INR11.5 billion borrowings through 54-EC bonds (INR16.3 billion last year). In FY10, INR74.0 billion was received from Cess fund (INR69.7 billion last year) and INR2.0 billion were received from budgetary support (INR1.5 billion last year).
- Progess under other roads development programmes:
  - National Rural Roads Development Agency (NRRDA) had sanctioned INR185 billion for rural roads development under the Bharat Nirman Programme, which was entirely availed by March 2010. Further, under Bharat Nirman new connectivity of 1,46,184 km of rural roads is expected to be provided to a total of 54,648 habitations.
  - Under the Pradhan Mantri Gram Sadak Yojna a total lenght of 0.4 million km roads at a cost of INR1,182 billion has been cleared till November 2010.
  - Phase A of SARDP-NE consists of 4,099 km roads construction (2,041 km of NHs and 2,058 km of State roads). Out of which 2,219 km has been approved till December 2010. Phase B involves 1,285 km of NHs and 2,483 km of state roads. Till December 2010, a detailed project report had been prepared for 450 km.

- **Railways:** Increase in freight revenue is one of the most important agenda for railways. To achieve higher utilization and thereby increase freight revenue several reforms were initiated including rationalization of freight structure, increasing transparency, simplification and introduction of measures to make rail traffic more competitive.
  - During April—November 2010, freight loading was recorded at 593.4 million tonnes (MT), as compared with 574.4 MT during the same period in 2009. It was short of target by 11.68 MT.
  - Indian Railways plan to add 206 more railway stations to the existing list of 378 Adarsh Stations. Initiatives were taken to improve basic facilitates such as drinking water, waiting rooms and catering services.
  - Steps were taken to improve safety, which reduced accidents per million train kms from 0.55 in FY02 to 0.17 in FY10.
  - To optimize the operational expenditure by obtaining electricity at economical rates, Indian railways and National Thermal Power Corporation (NTPC) have formed a joint venture (JV), which involves setting up of a 1000 MW Thermal Power Plant to be operational in 2012.
  - Indian railways plans to set up a Greenfield electric loco manufacturing unit at Madhepura, Bihar, through the public private partnership (PPP) route.
  - Two dedicated rail freight corridors have been implemented which comprises western DFC (1,534 km) from Mumbai to Rewari and Eastern DFC (1,839 km) from Ludhiana to Dankuni at an investment of INR507.7 billion.



- **Aviation :** The Civil Aviation Sector experienced a strong recovery during 2010.
    - During January–December 2010, domestic passenger traffic increased y-o-y by 19% to 51.5 million.
    - During the same period, domestic cargo transported by air increased 30% to 4.7 MT.
    - Currently, 12 scheduled airlines are operational with a fleet of 419 aircrafts.
- **Airports development:** According to the industry forecasts, India will be the fastest growing civil aviation market in the world by 2020 with around 420 million passengers being handled by the Indian airport system as against 140 million in 2010. In order to meet the expected growth in demand, following measures have been taken to develop airport infrastructure:
    - Phase-1 of the development work at the Indira Gandhi International Airport (IGIA), Delhi, has been completed with the commencement of Termial-3 at an estimated cost of INR128.5 billion.
    - Development work at Chhatrapati Shivaji International Airport (CSIA), Mumbai, is expected to be completed by 31 December 2012 with an estimated cost of INR98.0 billion.
    - Modernization of Kolkata and Chennai airports are expected to be completed in 2011 at an estimated revised costs of INR23.2 billion and INR20.1 billion, respectively.
    - Out of 35 non-metro airport development projects, 11 have been completed, and remaining 19 are in planning stage or in progress.
- **Power & utilities**: Electricity generation target for FY11 is 830.8 billion KWh, reflecting a growth of 7.7% over FY10. However, between April–December 2010, power generation has witnessed a growth of only 4.5% as compared with 6.2% during the same period in 2009. Nuclear power generation registered a growth of 33% followed by hydro (8%) and thermal (3%).
    - During April–December 2010, the peak and total energy deficits declined to 10.2% and 8.8%, respectively from 12.6% and 9.8%, respectively, during the corresponding period in 2009.
    - Since April 2007, 32,032 MW additional capacity has become operational and projects with a capacity of 30,725 MW are currently under construction and are expected to be operational by FY12.
- **Key policy measures:**
    - The Government of India launched Power System Operation Corporation Limited (POSOCO) in October 2010 to manage load dispatch functions, which was earlier being managed by the power grid.
    - The Central and State Electricity Regulatory Commissions has sanctioned 47 inter-State trading licenses, out of which 38 were in existence as on 31 December 2010.
    - Several measures were taken to promote green power, enhancing rural electrification, energy conservation and efficiency improvement.



Union budget 2011: impact

Policy measures:

Some key policy measures announced by the Finance Minister which could impact the infrastructure sector are as under:

- Allocation of INR 2,140 billion for infrastructure in 2011-12 (an increase of 23.3 per cent over 2010-11). This amounts to 48.5 per cent of total plan allocation.
- Foreign investment liberalization: To enable Indian Mutual Funds to have wider access to foreign investors, SEBI registered Mutual Funds will be allowed to accept subscriptions for equity schemes from foreign investors who meet the KYC requirements. Currently, only FIIs, sub-accounts registered with SEBI and NRIs are allowed to invest in Mutual Fund schemes.
- FII investment limits raised for infrastructure sector: FII limit for investment in corporate bonds will be enhanced by an additional amount of INR 900 billion for investment in corporate bonds, with residual maturity of over five years, issued by companies in infrastructure sector. FII investment limit for infrastructure bonds will thus be raised to INR 1125 billion and the total limit for corporate bonds will now be INR 1800 billion.
- FII allowed to invest in unlisted companies in Infrastructure sector: FIIs will be permitted to invest in unlisted bonds of infrastructure companies organized in the form of SPVs. Such investment will have a minimum lock-in period of three years. The FIIs will, however, be allowed to trade amongst themselves during the lock-in period.
- Infrastructure Debt Fund: To attract foreign investment in infrastructure, the Government will notify special vehicles in the form of infrastructure debt funds.
- Warehousing: Corpus of Rural Infrastructure Development Fund (RIDF) XVII to be enhanced to INR180 billion in 2011-12 from INR160 billion in the current year. The additional allocation of INR20 billion will be dedicated to creation of warehousing facilities.
- Cold chain facilities: Capital investment in the creation of modern storage capacity will be eligible for viability gap funding scheme of the Finance Ministry. Cold chains and post-harvest storage will be recognized as an infrastructure sub-sector.
- Fertilizer sector: Capital investment in fertilizer production will be included as a infrastructure sub-sector considering the capital intensive nature of the projects and high risk.
- IIFCL disbursals and takeout financing :India Infrastructure Finance Company Limited (IIFCL) will target cumulative disbursements of INR200 billion by March 31, 2011 and INR250 billion by March 31, 2012 for providing long term financial assistance to infrastructure projects. The take out financing scheme has been implemented and seven projects have been sanctioned with a debt of INR15 billion. Another INR50 billion to be sanctioned during 2011-12.
- Government proposes to come up with a comprehensive policy for further developing PPP projects.

Direct tax impact:

- Base rate of corporate tax to remain unchanged at 30% for domestic companies and 40% for foreign companies.
- The rate of surcharge reduced from 7.5% to 5% in case of domestic companies and from 2.5% to 2% in case of foreign companies.
- Minimum Alternate Tax (MAT) rate increased from 18% to 18.5%
- New levy of Alternate Minimum Tax (AMT) is proposed for Limited Liability Partnerships (LLPs). LLPs will be liable to pay AMT at 18.5% on adjusted total income if regular income-tax payable by such LLPs is less than AMT. AMT paid in excess of regular income-tax will be available as credit to be carried forward and set off against regular income-tax for ten succeeding years. The credit will be restricted to the extent of excess of regular income-tax over AMT.
- Benefit of investment linked deduction to be extended to the production of fertilizers if the operations are commenced on or after 01 April 2011 in new plant or in newly installed capacity in an existing plant. Investment-linked deduction is allowed as a 100% deduction in the year of commencement for any capital expenditure (except land, goodwill and financial instrument) incurred prior to commencement and capitalized in the books of account.
- Income of notified infrastructure debt fund, set up in accordance with the prescribed guidelines, will be exempt from tax.
- Interest received by a non-resident from infrastructure debt fund will be subject to tax at a lower rate of 5% on gross basis. The infrastructure debt fund will be obliged to withhold tax at such lower rate of 5% for interest payments to non-residents.
- Dividends received by Indian companies during FY 2011-12 from their foreign subsidiaries be taxed at a lower rate of 15%. No deduction of any expense will be allowed to the Indian company against such dividend income. Subsidiary foreign company means a foreign company in which the Indian company holds more than 50% in nominal value of equity share capital.
- In his speech, the Finance Minister has indicated that Direct taxes code (DTC) is proposed to be effective from 1 April 2012.

- Anti-avoidance measures introduced effective 1 June 2011 to discourage transactions with persons located in countries or territories which do not have effective information exchange arrangements with India.
    - Central Government will be authorized to notify countries or territories outside India as a Notified Jurisdictional Area (NJA).
    - Any transaction between two parties where one of the parties is located in a NJA will be deemed to be an international transaction subject to transfer pricing provisions. All parties to such transaction will be deemed to be associated enterprises.
    - While determining arm's length price of such international transactions, benefit of allowable variance of 5% (or such other percentage as may be notified by the Central Government) will not be available.
    - No deduction will be allowed for any expenditure or allowance (including depreciation) arising from such international transaction unless taxpayer maintains such documentation and furnishes such information as may be prescribed.
    - No deduction will be allowed for any payment made to a financial institution located in a NJA, unless the taxpayer authorizes income-tax authorities to seek relevant information from the said financial institution.
    - Any sum received by the taxpayer from a person located in the NJA will be deemed to be income of the taxpayer, unless the taxpayer satisfactorily explains the source of such money in the hands of such person located in the NJA.
    - Minimum WHT rate of 30% will apply on any sum or income which a person located in a NJA is entitled to receive.

Indirect tax impact:

Service tax

- Service tax rate of 10.3% retained
- Substantial changes in Cenvat credit Rules in order to move towards more rationalized regime. These include
  - Clarification that trading activity is an exempted service. This would have a significant impact on the manner in which Cenvat credit may be availed where a service provider is providing taxable service and is also rendering trading activity
  - Rule 6(5) which allowed 100% credit on certain specified services even if such services are partly used for taxable service has been removed
  - Input Service definition specifically excludes construction of building, part thereof except where the service provider is providing such services
  - Exempted Service definition has been amended to include services on which abatement is available
- Point of taxation Rules introduced to determine the applicable rate of Service tax and the date on which such payment of liability arises.
- Exemption from payment of Service tax under works contract service when such services are provided wholly within an airport or Port.

Customs duty

- Peak Customs duty rates remain unchanged.

Excise duty

- Peak Excise duty rates remain unchanged.
- Excise duty structure for Cement and Cement clinkers rationalised.
- Exemption on around 130 items has been withdrawn. Instead Excise duty of 1% (where Cenvat credit on inputs/ input services cannot be availed) or 5% (where Cenvat credit can be availed) has been levied on manufacture of such goods. These goods include various items which are used in Infrastructure sector such as Ready mix concrete, Railway related goods etc.

Shipping and ports:

Direct tax impact:

No sector specific proposals have been announced.

Indirect tax impact:

Customs and Excise

- Custom duty exemption currently available to ship repair units on import of spares and consumables required for repair of ocean going vessels is being extended to spares and consumables for repairs of ocean going vessels by owners of such vessels registered in India.
- Excise duty exemption on the following types of ships discontinued and 1% excise duty introduced with no CENVAT credit of taxes paid on inputs and input services:
    - Cruise ships, excursion boats, ferry boats, cargo ships, barges and similar vessels for transport of persons or goods
    - Tugs and pusher crafts
    - Light vessels, fire floats, dredgers, floating cranes, etc
    - Other vessels including life boats, other than rowing boats
- Consequently, the above stated goods would also attract Additional Customs Duty at 1% on imports.

Service tax

- Service tax exemption of 25% from taxable value is being provided to services of 'transport of coastal goods and goods transported through national waterways or inland water with no CENVAT credit of taxes paid on inputs, input services and capital goods. The effective service tax rate is 7.725%.

Roads & highways and railways:

Policy measures:

Some key policy measures announced by the Finance Minister which could impact the road, bridge and railways sector are as under:

- For the year 2011-12, Bharat Nirman, which includes Pradhan Mantri Gram Sadak Yojna (PMGSY) and other schemes have together been allocated INR580 billion.
- In order to give a boost to development of railways, ports, housing and highways, tax free bonds of INR 300 billion have been allowed to be issued by various Government undertakings in the year 2011-12. This includes INR 100 billion each by Indian Railway Finance Corporation and National Highway Authority of India.
- It has been announced that the ongoing Metro projects of Bengaluru, Kolkata and Chennai will be provided financial assistance for speedy implementation.
- The Rail Budget 2011 further announced proposal for setting up of factories under a PPP model which includes:
    - Factory for making the Refrigerated containers for the use of the railways
    - Rail axle factory at New Jalpaiguri (West Bengal)
    - Five wagon factories at various locations
- Rail Budget 2011 further proposes construction of a dedicated freight Corridor from Mumbai to Rewari (Haryana).

Direct tax impact:

No sector specific proposals have been announced.

Indirect tax impact:

- The benefit of full exemption from basic customs duty and CVD currently available to 'Tunnel Boring Machine' and parts thereof for hydro-electric power projects is being extended to such machines for highway development projects.

Power & utilities:

Policy measures:

- For 2011-12, Bharat Nirman, which inter alia includes Rajiv Gandhi Grameen Vidyutikaran Yojna amongst others, have together been allocated INR 580 billion which is an increase by INR 100 billion from last year.

Direct tax impact:

- Presently, the following undertakings in power sector enjoy a deduction in respect of profits and gains for a period of 10 years, if they are operative by 31 March 2011.

  a) generates and/ or distributes power
  b) starts transmission or distribution by laying a network of new transmission or distribution lines or
  c) undertakes substantial renovation and modernization of the existing network of transmission or distribution lines

  The terminal date is extended by 1 year and these undertakings now need to be operative by 31 March 2012 to avail such tax holiday.
- Benefit under section 80CCF has extended by 1 year to allow deduction of INR 20,000 for investment in notified long-term infrastructure bonds for the financial year 2011-12 also. This would channelize savings and investments in infrastructure bonds.

Indirect tax impact:

Excise duty

- In order to make supplies from domestic manufacturers competitive to foreign imports, Excise duty exemption has been granted to all machinery, equipments, their components and raw material used for the manufacture such machinery, equipments, supplied to Ultra Mega Power Projects/ Mega power projects or for the expansion of existing Mega Power Projects. The exemption would include goods which are required for development of facilities such as ash disposal system including ash dyke, water intake including treatment and storage facilities and coal transportation, both inside and also outside the power plant's designated boundary. Also this exemption has been extended to power cables used within the power generation plant. The condition that the goods to which such an exemption has been granted should be exempt from Customs duty as well, has been removed.

Customs duty

- Basic Customs duty and Counter vailing duty of Customs in lieu of Excise has been reduced to 5% on specified goods used in high voltage power transmission projects, subject to fulfillment of Actual User Condition. This would result in reduction of effective Customs duty on such goods to approx 15.15 from standard rate of 26.85%.

- 100% exemption from customs duty has been extended to toughened glass and silver paste imported for manufacture of solar cells or solar modules on actual user basis.

- Basic customs duty reduced from 5% to 2.5% on petroleum coke.

Aviation and airports:

Direct tax impact:

No sector specific proposals have been announced

Indirect tax impact:

Service tax

- Service tax on domestic economy class travel increased from Rs 100/- per journey or 10% of the value of the ticket (whichever is lower) to Rs 150/- per journey or 10% the value of the ticket (whichever is lower)
- Service tax on international economy class travel increased from Rs 500/- per journey or 10% of the value of the ticket (whichever is lower) to Rs 750/- per journey or 10% of the value of the ticket (whichever is lower)
- Abatement on domestic premium travel of 100/- per journey or value of the ticket (whichever is lower) has been removed. Service tax would be applicable at the rate of 10.3% (including cess) on premium domestic travel
- Exemption on transportation of goods by air when the goods are transported from a place outside India to a destination outside India
- Exemption on transportation of goods by air on the amount of air freight on which customs duty is paid
- Transportation of goods by air - Condition for qualification as export or import of services amended from performance base (i.e. part performance in India) to location of service recipient
- Exemption on works contract executed wholly within an airport

Excise duty

- Excise duty on balloons, gliders, parachutes, aircraft launching gear, deck-arrestor similar gear, ground flying trainers subject to 1% concessional duty without cenvat credit. Excise duty of 5% where cenvat credit availed.

Customs duty

- Exemption from education cess and secondary & higher education cess on import of aircraft removed
- **Basic customs duty of 2.5% to be levied on import of aircraft for providing non scheduled passenger and charter services.**
- Basic customs duty on import of pneumatic tyres for aircrafts reduced from 3% to 2.5%

Sources:

1. "Economic Survey 2010-2011", *Union Budget & Economic Survey Website*, http://indiabudget.nic.in/index.asp, accessed 25 February 2011.
2. "Union Budget 2011-2012", *Union Budget & Economic Survey Website*, http://indiabudget.nic.in/index.asp, accessed 28 February 2011.

Our Offices

Ahmedabad
2nd Floor, Shivalik Ishaan
Near CN Vidhyalaya,
Ambawadi,
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru
"UB City", Canberra Block
12th & 13th floor
No.24, Vittal Mallya Road
Bangaluru - 560 001
Tel : + 91 80 4027 5000,
+ 91 6727 5000
Fax: + 91 80 2210 6000
(12th Floor)
Fax: + 91 80 2224 0695
(13th Floor)

Chennai
TPL House, 2nd floor
No 3, Cenotaph Road
Teynampet
Chennai - 600 018
Tel: + 91 44 4219 4400
Fax: + 91 44 2431 1450

Gurgaon
Golf View Corporate Tower - B
Near DLF Golf Course
Sector 42
Gurgaon - 122002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

Hyderabad
205, 2nd floor
Ashoka Bhoopal Chambers
Sardar Patel Road
Secunderabad - 500 003
Tel: + 91 40 6627 4000
Fax: + 91 40 2789 8851

Kolkata
22, Camac Street
Block 'C', 3rd floor
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai
6th floor & 18th floor
Express Towers
Nariman Point
Mumbai - 400 021
Tel: + 91 22 6657 9200
(6th floor)
Fax: + 91 22 22876401
Tel: + 91 22 6665 5000
(18th floor)
Fax: + 91 22 2282 6000

Jolly Makers Chambers II
15th floor, Nariman Point
Mumbai - 400 021
Tel : + 91 22 6749 8000
Fax : + 91 22 6749 8200

Jalan Mill Compound
95, Ganpatrao Kadam Marg
Lower Parel,
Mumbai - 400 013
Tel: + 91 22 4035 6300
Fax: + 91 22 4035 6400

New Delhi
6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 4363 3000
Fax: + 91 11 4363 3200

Pune
C-401, 4th floor
Panchshil Tech Park
Yerwada (Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6601 6000
Fax: + 91 20 6601 5900

Ernst & Young Pvt. Ltd.

Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 144,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com

For more information, please visit www.ey.com/india