India Union Budget 2024-2025

Point of view

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Aerospace and Defence

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Budget Allocations for the Aerospace and Defence sector

- With the first budget presented by NDA 3.0 on 23rd July 2024 INR 621,941 crore (~ USD 74.48 Bn) is allocated towards the total Defence Budget (including Defence pensions) for FY 2024-25.
- The breakup of the budgetary allocations into capital and revenue expenditure, along with the comparative figures of Budget 2023 are as below:

(in INR crore)

Particulars	FY 2024-25	FY 2023-24	Percentage Change
Capital Expenditure	INR 172,000 (~USD 20.6 Bn)	INR 162,600 (~USD 19.47 Bn)	**6%**
Revenue Expenditure	INR 282,773 (~USD 33.87 Bn)	INR 270,120 (~USD 32.35 Bn)	5%
Defence Pension	INR 141,205 (~USD 16.91 Bn)	INR 138,205 (~USD 16.55 Bn)	2%
Ministry of Defence (Civil)	INR 25,963 (~USD 3.10 Bn)	INR 22,613 (~USD 2.71 Bn)	15%
Total Defence Budget	**INR 621,941 (~USD 74.48 Bn)**	**INR 593,538 (~USD 71.08 Bn)**	**5%**

- The afore-mentioned allocations stand similar to the allocations announced in Interim Budget in February 2024 except a nominal increase of INR 400 crore (~USD 0.05 Bn) under the head MoD (Civil). There is an increase of 5 per cent in the overall Defence budget of FY 2024-25 as compared to the original budget of FY 2023-24 and negligible change as compared to the revised estimates of FY 2023-24.

- Further, the capital expenditure on Defence services is envisaged as below*:

(in INR crore)

Particulars	Allocations	% of total capital outlay
Aircraft and Aero Engines	INR 40,278 (~USD 4.82 Bn)	23%
Other Equipment	INR 62,198 (~USD 7.45 Bn)	36%
Naval Fleet	INR 23,800 (~USD 2.85 Bn)	14%
Construction Works	INR 12,017 (~USD 1.44 Bn)	7%
Technology Development	INR 1,797 (~USD 0.22 Bn)	1%
Others (Land, Naval Dockyards, Special Projects etc.)	INR 31,910 (~USD 3.82 Bn)	19%
Portion of total expenditure covered	**INR 172,000 (~USD 20.6 Bn)**	

**excluding allocation towards Ministry of Defence (Civil)*

Key announcements for the sector

Direct Taxes

- The corporate tax rate for non-resident entities has been reduced from the baseline rate of 40 per cent (effective tax rate of 43.68 per cent) to 35 per cent (38.22 per cent) and thus effectively reducing it by 5.46 per cent. This would have a positive impact on foreign entities having taxable presence in the form of branch offices, project offices or Permanent Establishments (PEs) of foreign companies in India.
- Abolition of 'angel tax' on companies - For a closely held company which receive any consideration for issue of shares, the aggregate consideration received for such shares exceeding such fair market value shall going forward, not be chargeable to income tax under the head "Income from other sources".
- No extension has been provided for availing the concessional corporate tax rate of 15 per cent for manufacturing entities, on the deadline for commencement of manufacturing operations beyond 31 March 2024.
- With effect from 1 August 2024, the Government has decided to abolish Equalisation levy ('EL' or 'digital tax') @ 2 per cent currently applicable on non-residents on online sale and services. This is a welcome move for non-resident businesses as the same addresses the ambiguity of their income getting covered under the normal provisions of the Indian Income-tax Act, 1961 ('the Act') or under EL.
- Key changes proposed in the taxation provisions of Capital Gains are as below:
  - Short term capital gains tax on listed equity shares (where securities transaction tax (STT) is paid) is proposed to be increased to 20 per cent from the present rate of 15 per cent

- Long term capital gains tax rate is proposed to be changed to 12.5 per cent for majority of assets (earlier rate was 10 per cent to 20 per cent). With rationalisation of rate to 12.5 per cent, indexation benefit available under second proviso to section 48 of the Act is proposed to be removed for calculation of any long-term capital gains which is presently available for property, gold and other unlisted assets
- Period of holding for classification as long term capital assets also rationalized (either 12 months or 24 months)
- Sum paid by a domestic company on buy back of shares is proposed to be treated as dividend in the hands of shareholders and chargeable to tax at applicable rates. Further, no deduction for expenses shall be available against such dividend income. The cost of acquisition of the shares which have been bought back would separately generate a capital loss in the hands of the shareholder as these assets have been extinguished.

- Thin capitalisation rules not applicable to finance companies in International Financial Services Centre (IFSC) - In an Indian company or PE of a foreign Company in India (i.e. the borrower), a restriction is placed on deduction of interest expense from the taxable income in respect of any debt issued by a non-resident, being an associated enterprise of the borrower. It is now proposed that the provisions of this section shall not apply to finance companies located in IFSC in India.
- Considering multiple sections relating to withholding of taxes with varying threshold and rates ranging from 0.1 per cent to 30 per cent, WHT obligation had become too complicated. As a first step towards its simplification, the Budget proposes to reduce the WHT rate for certain categories of expenditure (from 5 per cent to 2 per cent).

Indirect Taxes

- Customs duty rate rationalization to support domestic manufacturing, deepen local value addition, removal of duty inversion and promote export competitiveness.
- Exemption from GST Compensation Cess on imports in SEZ made effective retrospectively from 1 July 2017.
- Basic customs duty (BCD) exemption/reduction on 27 critical minerals - beneficial for several sectors including defence and space manufacturing.
- Various BCD exemptions /concessions extended up to 31 March 2026/2029 (earlier available till 30 September 2024).
- Exemption on import of aviation turbine fuel in the tanks of aircrafts of an Indian Airline or of the Indian Air Force applicable till 31 March 2029.
- Nil BCD prescribed on import of following goods till 31 March 2025 (effective immediately):
  - Components and consumables for use in manufacture of specified vessels
  - Technical documentation and spare parts for construction of warships.
- Following import duty exemptions allowed to be lapsed on 30 September 2024
  - Specified goods imported by United Arab Airlines
  - Aircraft engines, spares imported by Indian Airlines and Air India International
  - Catering cabin equipment, food and drink re-imported by aircrafts of the Indian Airlines Corporation from foreign flights, under Sea Customs Act.

- Time limit for re-importation and re-exportation extended for purpose of duty benefits in few cases as follows:
  - For re-export of aircraft and vessels imported for maintenance, repair or overhauling (MRO) extended to 1 year from 6 months
  - For re-import of goods exported from India under warranty (other than those under export promotion schemes) extended to 5 years from 3 years.
- Introduction of specific sub-classifications for following tariff entries effective 1 October 2024 (no change in tariff rate)
  - Blended aviation turbine fuel (2710 19 33): Specific supplementary note has also been inserted to define such fuel
  - Machinery for use in goods of chapter 88 or 89 pertaining to aircrafts or ships (8479 90 80)
  - Specified electrical goods for use in goods of chapter 88 or 89 or 93 (8537 10 10) and others (8537 10 90)
  - Parts other than specified for aero planes, helicopters (8807 30 10) and unmanned aircraft (8807 30 20)
  - Patrol or surveillance boat, air-cushion vehicle, remote-operated vehicle (8906 90 10) and other vessels (8906 90 90)
  - Parts and accessories of goods of heading 9304 (9305 99 10) and other arms (9305 99 90)
  - Specific armour/headgear for ballistic protection (3920 10 93, 6307 90 92, 6506 10 20, 6914 90 10).

Key takeaways for the space sector

- The Department of Space (DoS) is allocated INR 13,043 crore (~USD 1.56 Bn) in the Budget 2024, out of which INR 5,568 crore (~USD 0.67 Bn) is earmarked towards the capital expenditure. There has been an increase in the overall budget of INR 1,973 crore (~USD 0.24 Bn) i.e. increase by 18 per cent as compared to the revised estimate of FY 2023-24.
- Major part of the space budget is earmarked for space technology with ~23 per cent increase in the space technology spending earmarked in FY 2024-25 over revised estimate of FY 2023-24.
- The budgetary allocation to NSIL is retained at INR 1 crore which indicates the space sector Public Sector Undertaking (PSU) is expected to be self-reliant for its growth and to judiciously utilise the equity infusion of INR 900 crore (~USD 0.11 Bn) made in the PSU in FY 2021-22.
- With a continued emphasis on expanding the space economy by 5 times in the next 10 years, a venture capital fund of 1,000 crore (~USD 0.12 bn) is proposed to be set up.
- There has been a significant increase of ~19 per cent in the budget for the central government schemes/ projects in the space sector thereby indicating government's intent towards promoting the sector. These include schemes specific to space technology, sciences, applications and satellite systems.

Key Implications for the sector

- By re-affirming the allocations announced in the interim Defence budget in February, the Aerospace and Defence sector has yet again been provided the highest budget allocation (at 13 per cent of the overall budget) amongst all the sectors by the Indian Government. Though, the overall Defence budget only gets a 5 per cent y-o-y increase, the Defence budget crossed the INR 6 Lakh crore threshold this year for the first time (~USD 74.48 bn).
- While the proposed capital outlay at INR 1.72 Lakh crore (~USD 20.6 bn) has seen an increase in absolute on yearly basis, there has been nominal 6 per cent y-o-y increase (vis-à-vis ~9 per cent increase from revised estimates) and certainly misses industry expectations.
- The final budget also misses the detailed allocations for the three divisions of the Defence services i.e. Indian Army, Indian Navy and Indian Airforce. Key highlights of the capital budgetary allocations across various activities are as below:
  - Allocation towards 'aircraft and aeroengines' has increased for all the services from INR 28,222 crore (~USD 3.40 Bn) in FY 2023-24 to INR 40,278 crore (~USD 4.82 Bn) in FY 2024-25. An increase of more than INR 12,056 crore (~USD 1.44 Bn/ ~43 per cent). This is likely linked to the procurement of platforms such as the C 295, Tejas Mk1, aeroengines and helicopters such as Prachand
  - Allocation towards 'naval fleet' has decreased from INR 24,200 crore (~USD 2.90 Bn) in FY 2023-24 to INR 23,800 crore (~USD 2.85 Bn) in FY 2024-25. This marginal decrease of INR 400 crore (~USD 0.05 Bn/ ~2 per cent) typically does not reflect any reduction in budget allocation for future naval fleet acquisition programs. This may be attributable to minor variations in yearly outgo of committed liabilities, which are in-turn dependent on completion of stages of ongoing shipbuilding programs
  - Expenditure on 'Research & Development' increased by INR 358 crore (~USD 0.04 Bn) over FY 2023-24, an increase of about 2.8 per cent.
  - Allocation towards Rashtriya Rifles has increased from INR 100 crore (~USD 0.01 Bn) in FY 2023-24 to INR 200 crore (~USD 0.02 Bn) in FY 2024-25. 100 per cent increase indicates equipping of the forces to handle internal security issues.
- In the revenue procurement budget, majorly, expenditure on stores by the Army has reduced from INR 23,965 crore (~USD 2.87 Bn) in FY 2023-24 to INR 22,036 crore (~USD 2.64 Bn) in FY 2024-25. A decrease of INR 1,929 crore (~USD 0.23 Bn/ ~8 per cent).
- In the tax proposals, grant of BCD exemption on certain minerals critical to Defence and Space sector, extension of BCD exemptions concessions timeline etc. is a welcome move to boost in-country manufacturing. Other several key measures such as rationalization of GST on import of components or parts to 5 per cent required for MRO activities, extension of time limit for re-importation and re-exportation extended for purpose of duty benefits etc. reflects government's efforts to promote innovation, efficiency in order to develop a strong and efficient aviation industry.
- While many constructive policy reforms have been announced in the defence sector (including introduction of multiple positive indigenisation lists for defence public sector undertakings as well as private companies, introduction of amendments to defence acquisition procedure, removal of restriction on wholly owned subsidiary being an Indian offset partner, first government approval to a company for 100 per cent FDI in Defence sector etc.), certain key asks of the industry are still a miss, such as:
  - Introduction of production linked incentive scheme;
  - Extension of the deadline of concessional tax rate for commencement of manufacturing activities;
  - Rationalization of MRO rate currently appears to apply exclusively for civil MRO centers. Although exemptions are already in place for Defence MROs (period for which has been extended), their applicability may not be universal. Hence, the issue of inverted tax structure might still persist for defence MRO centers

- In the absence of any clarification/amendment to address the inconsistency in current definition of Indian vendor for defence acquisitions, Indian subsidiaries/JVs with 74% shareholding of OEMs are still not at par with Indian owned and controlled entities, for all capital acquisitions.

- While, ‘Make in India’ continues to be at a centerstage, with the Defence production increasing to INR 1.27 Lakh crore (USD 15.21 bn) in FY 2023-24 and India’s transition to the list of the top 25 arms exporter nations, aforementioned exclusions could be a deterrent to the Government’s ambitious vision of achieving a turnover of INR 175,000 crore (~ USD 20.96 Bn) including exports of INR 30,000 crore (~ USD 3.59 Bn) in Aerospace and Defence goods and services by FY 2024-25.

Note – All figures have been converted to USD using the exchange rate of USD 1 = INR 83.5 as in July 2024

KPMG in India contacts:

Gaurav Mehndiratta
Partner and Head
Aerospace and Defence
E: gmehndiratta@kpmg.com

Abhishek Verma
Partner
Aerospace and Defence
E: abhishekverma5@kpmg.com

Girish Nair
Partner and Head, Aviation
E: nairgirishg@kpmg.com

kpmg.com/in/socialmedia

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000.

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