Union Budget 2013-14

Impact on the Aviation sector

March 2013

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An overview

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With a robust domestic growth of 25.6%, the Indian aviation sector has tripled its growth within a span of the past five years, becoming the fastest growing market in the world (IATA). It has emerged as the most crucial industry of the country, while generating employment opportunities and stimulating growth of other industries.

According to a recent report of the research firm - RNCOS, India is the ninth largest aviation market in the world. A recent report by IATA also states that the sector currently contributes Rs 33,000 Crore or 0.5% of the country's GDP, while also supporting 1.7 million jobs.

Various foreign and Indian investors in recent times have shown trust in the fundamentals of the sector, however, it cannot be denied that ailments of the sector cannot be left unattended for long.

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Growth drivers

Some of the key drivers fuelling the growth momentum of the Indian aviation sector are:

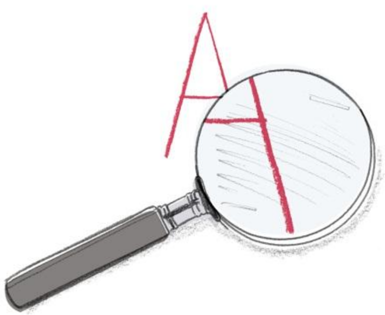
- new wave of growth in the Indian tourism industry
- increasing levels of disposable incomes
- greater integration of businesses globally
- growth in consumer spending
- increase in inflows of Foreign Direct Investment (FDI)
- rise of Low Cost Carrier (LCC) model
- large-scale investments in the airport infrastructure
- thrust by the Central and State Governments to enhance connectivity in remote and inaccessible regions of the country
- growth in air-cargo industry

An overview

Challenges

Transportation is one of the most important wheels for growth in any economy, and in present time, air travel is no longer an elitist luxury but a necessity. The free spinning of this wheel has been obstructed by several factors. Some of the key challenges impacting the financial health of the Indian aviation sector in recent times include:

- intense competition
- spiralling fuel prices
- high operating costs.
- declining air traffic
- rupee depreciation
- high debt-equity ratio
- underdeveloped infrastructure



Budget impact

The Indian Aviation industry is one of the fastest growing industry in the world. It has emerged as the most crucial infrastructure of the country, while generating employment opportunities and stimulating growth of other industries.   Despite this great triumph, the aviation sector has been facing significant challenges over the past several years. The fate of the industry is such that almost all the carriers are in the red.

Last year's budget provided some tax and non-tax incentives to the sector, but they were not enough to cure the maladies. Pricing and tax structure of Aviation Turbine Fuel (ATF) continues to be the single biggest factor for the strain on the resources of most carriers. Fuel for other modes of public transport are subsidised, whereas ATF is subject to excessive taxation. Categorisation of ATF as declared goods was not to be!

Despite the acknowledgement of need to develop MROs in India, the sops provided may be too little to spur investments. Further, in an industry where all contracts are net of taxes, the increase in the rate of withholding on fee for technical services and royalty, will have a crippling effect when contracting with a vendor where tax treaty protection is not available.

There may not be much to cheer for in the Budget where the sector was looking expectantly towards Government for tax rationalisation, which most of them believe would be enough for them to soar again.

Key expectations

An urgent need to revive and strengthen the aviation industry is palpable. The government needs to look into rationalising tax and introduce some radical changes to help one of the most promising industry of the economy. Some of the key expectations of this sector were:

- subsidisation of aviation fuel, to bring travel by air at par with other modes of public transport
- introduce tax incentives/exemptions to encourage 'Maintenance, Repair & Overhaul' (MRO) facilities in India to help reduce airline's overall costs and save foreign exchange outflows
- provision of exemption/ abatement in service tax rate on third party services, ground handling and catering services which would help in controlling the operating costs
- categorise ATF as "declared goods" so as to curb tax costs and ensure a uniform rate of tax across states
- extend the benefit of carry forward of losses in case of mergers and amalgamations of Aviation companies
- re-introduce exemption to non-residents aircraft / aircraft engines lessors, taking into consideration that most of the airline contracts are net of tax and taxes are borne by Indian companies

Direct tax proposals

Budget 2013 does little to fulfill the expectations of the sector from a direct tax perspective despite the fact that the industry is bleeding given their current operating cost structure.

One of the biggest cost item for a carrier is MRO. Presently there are only two MRO facilities in India and most of maintenance and repairs happen outside the country. This means additional cost of ferrying parts, downtime for airlines apart from a drain on foreign exchange resources for the country. India has the potential to become an MRO hub and a direct tax incentive may have provided the required impetus.

Rate of tax for royalty and fee for technical services paid to non residents has been increased to 25% from the existing 10%. This comes close in the heels with the expansion in definition of royalty made last year with retrospective effect. The tax cost will come to the account of the Indian carriers because most agreements in the sector are net of taxes. This may be substantial in cases where the vendor is resident in a country, the tax treaty with which, does not moderate the tax rate on such payments

Indirect tax proposals

Service Tax

Standard rate of service tax is retained at 12%

Taxability of repair/maintenance of aircraft

- repair/maintenance services provided to Government or local authorities in relation to aircraft has become taxable. Similar services provided to private sector were already under the tax net

Customs

Peak rate of Basic Customs Duty retained at 10%.

Tariff changes

- education cess exemption (including secondary and Higher education cess exemption cess is being withdrawn on aeroplanes, helicopters and their parts
- customs duty exemption on parts and testing equipment for maintenance, repair and overhauling of aircraft is being extended to aircraft parts
- exemption benefits also extended to private aircrafts and foreign airlines
- it has been clarified that exemption on certain aircraft parts (other than rubber tyres) of aircraft is available to foreign airlines also

Non tariff changes

- time period for consumption/installation of parts and testing equipment imported for MRO of aircraft is being increased from 3 months to 1 year

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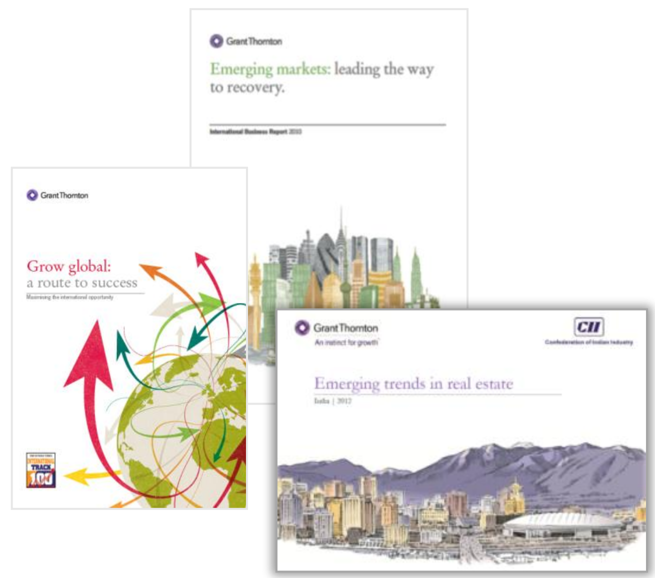

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