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BUDGET ANALYSIS

IMPACT ON INFRASTRUCTURE

February 2017

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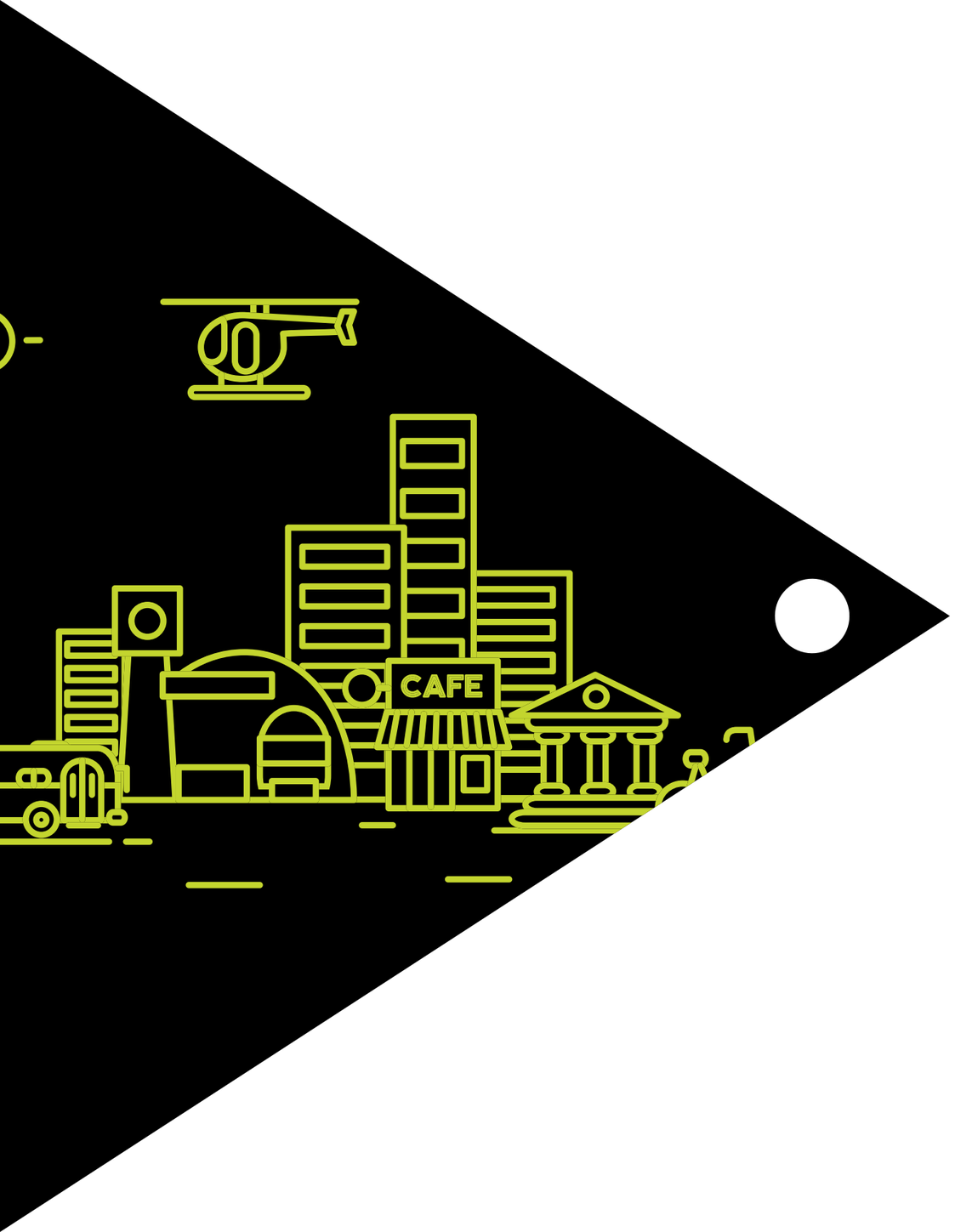


Foreword

Infrastructure investment and development agenda has been one of the key priorities of the extant Government and the earlier budgets also focused on substantial outlay for infrastructure sector backed with policy announcements to address the key concerns of the sector.

Run-up to the Budget for financial year (FY) 2017-18, the Government was faced with a daunting challenge to reinforce the development agenda & the flagship Infrastructure programs of the Government, of addressing the impact of demonetisation on the sector, and at the same time ensuring a populist budget in wake of upcoming state elections. In addition, the Budget was expected to introduce measures to improve ease of doing business in the sector, address financing & contractual issues for stuck projects resulting in increasing non performing assets (NPAs) for the banks and simplify the tax regime for infrastructure projects & the entities involved.

The Government has been able to partially meet the expectations. The Budget continues to place emphasis on infrastructure development with an increased outlay of INR 3,961 billion for infrastructure in the budgeted expenditure for FY 17-18. With the merging of Railways Budget with the Union Budget, market was looking forward for key announcements to address long standing needs of the sector. The establishment of a Rail Safety Fund and the focus on railways cleanliness, and redevelopment of stations are welcome announcements. A good allocation of capex for transportation, rural and other infrastructure, including for water efficient micro irrigation are also encouraging steps, as also the development of select airports in tier II cities, supplementing the regional connectivity initiatives.

However, omission of any concrete provisions on important infrastructure areas such as ports & shipping and no follow on of critical announcements made in the previous budgets, such as such as National Infrastructure Investments Fund, Public Private Partnership (PPP) Institute, urban infrastructure development schemes came as a dampener.

Status of infrastructure sector to affordable housing, which has long been demanded by the industry, is also expected to provide the much-needed boost to the sector thus furthering the social agenda.

In addition to providing high budgetary allocations to the infrastructure sector, the Budget has introduced additional measures to address some long standing issues in the sector, namely:

In addition to providing high budgetary allocations to the infrastructure sector, the Budget has introduced additional measures to address some long standing issues in the sector, namely:

i) Institutional and legislative initiatives will be undertaken to improve resolution of disputes in PPP contracts and an amendment to the 'Arbitration and Conciliation Act 1996 will be introduced;
ii) Carry forward of Minimum Alternate Tax (MAT) credit has been allowed for 15 years instead of existing limit of 10 years, which is expected to positively impact viability of infrastructure projects;
iii) A move to accelerate listing of public utilities would provide options for better governance and leveraging of resources from the market.

In addition, a general push on digital economy and development of related infrastructure will open up ways for better and efficient ways of governance and management across sectors.

Policy Updates

Summary

The Government has reiterated its commitment to infrastructure led development agenda. The Budget has given overall positive signals for infrastructure sector and companies with significantly higher allocation for all subsectors and a total outlay of INR 3,961 billion. The Budget does well in balancing the expectation for a populist budget as well as need of fiscal prudence. There is strong focus on rural, irrigation and farm sector, and infrastructure development beyond the tier I cities. A substantial safety fund in railways and enhanced allocation of capex for roads, railways and other infrastructure is a positive step. According infrastructure status to Affordable Housing is also a positive step to mainstream investments in the sector. Indication of encouraging PPPs in all infra sectors along with mechanisms to address disputes will give a boost to potential new investors. Operation & maintenance PPPs in tier II city airports will improve services and consequently the air traffic to such cities aided by recent regional air connectivity program of Ministry.

On an overall basis, the Budget provision offer a substantive promises to the infrastructure sector, however, as has been seen with earlier budgets of the extant Government, more detailing is required for implementation/delivery mechanism and follow-up of on the budget promises.

Key Highlights

Focus on development of infrastructure for masses - emphasis on rural infrastructure, agriculture & allied infrastructure, passenger safety and convenience for railways.

Infrastructure status for affordable housing – long awaited demand from the sector.

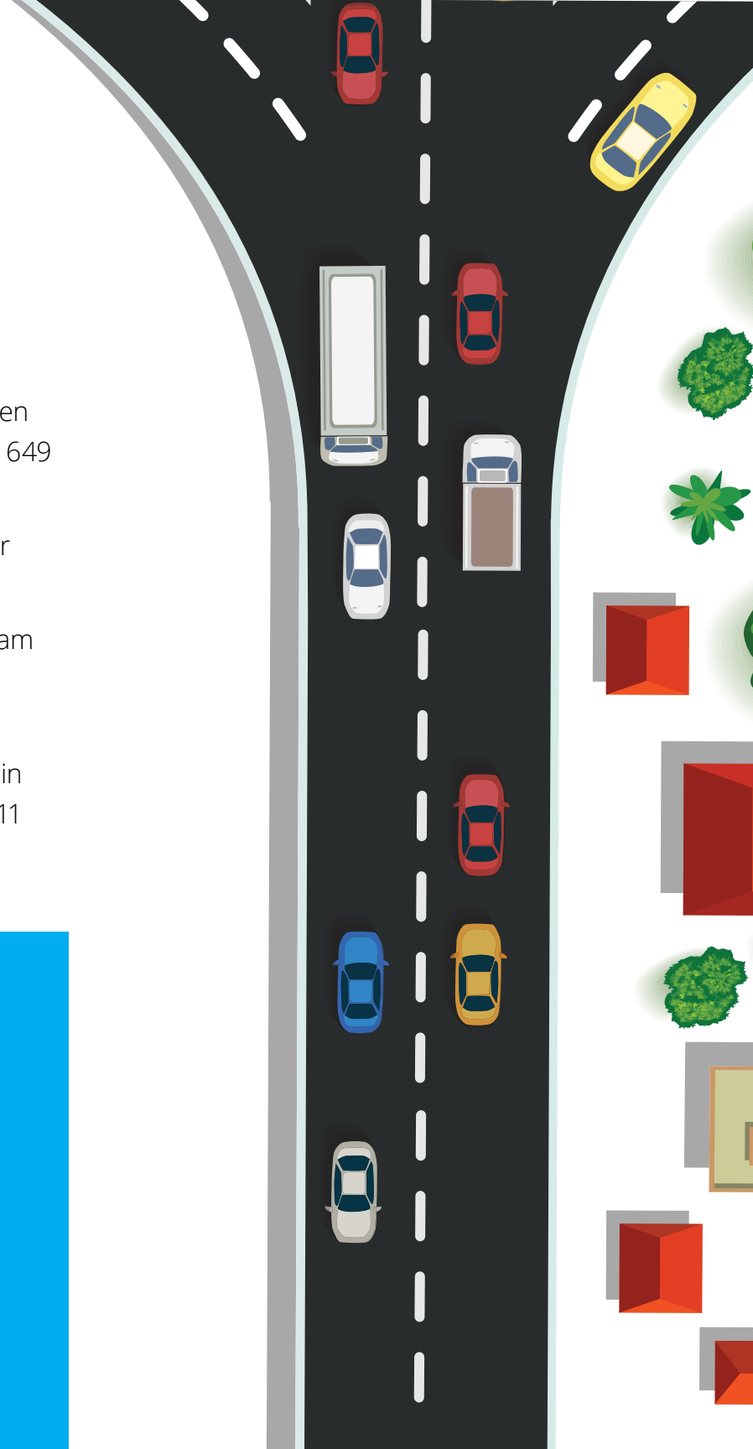
Increased outlay of INR 2,413 billion for the transportation sector with a focus on multi-modal connectivity development; adequate attention ensured for railways.

Roads & Highways

Budget announcement

- Budgetary allocation for National Highways has been increased from INR 579.76 billion in 2016-17 to INR 649 billion in 2017-18.
- Development of 2,000 kms of roads & highways for coastal connectivity has been announced.
- Total length of roads [including Pradhan Mantri Gram Sadak Yojana (PMGSY)] built from 2014-15 till the current year is about 140,000 kms.
- Under PMGSY, 133 kms were constructed per day in 2016-17 against an average of 73 kms between 2011 and 2014.

> "The allocation of INR 649 billion to the development of National Highways is below expectations. Such an allocation shall result in increased borrowing pressure on NHAI to meet the financial requirements of its development plan"



Other recent policy updates

- Bharatmala Programme – The Government has launched key constituents of the Bharatmala Programme (a road connectivity umbrella scheme) such as Setu Bharatam Pariyojana & Char Dham.
- Release of 75% of arbitral award challenged in court – As per the decision taken by the Cabinet Committee on Economic Affairs (CCEA), cases where the arbitration tribunals have passed orders in favour of the contractors/ concessionaires in arbitral proceedings and such awards/ orders have been further challenged by National Highways Authority of India (NHAI) in courts of law, NHAI is required to pay an amount equal to 75% of the total pay-out (i.e. arbitral award amount including the interest payable as per such Award, if any) to the contractors/ concessionaires against a bank guarantee subject to certain conditions.
- Toll, Operate and Transfer (TOT) model – The Government has signaled its intent to issue bids for national highways on the TOT model, a unique asset monetisation exercise. Draft bidding documents (request for proposal and model concession agreement) have been put in the public domain and stakeholder consultations have taken place on the same.

"The rise in pace of roads construction per day from 73 kms in 2011-14 to 133 km in 2016-17, is laudable. Increased focus on connectivity to ports and remote areas, along with legislative initiatives to provide stimulus to infrastructure to kick-start stuck PPP projects are welcome measures."

Railways

Budget announcement

- Outlay for Indian Railways for the 2017-18 is INR 1,310,000 million vis-à-vis INR 1,210,000 million in 2016-17. The budgetary allocation for the BE 2017-18 is INR 550,000 million.
- 3,500 kms of new railway line to be commissioned in 2017- 18 vis-à-vis 2,800 kms during 2016-17.
- To ensure passenger safety, Railway Safety Fund – 'Rail Sanraksha Kosh'- will be set up with a corpus of INR 1,000 billion with seed capital contribution from Central Government. Additionally, all unmanned railway crossings to be eliminated by 2020. Expert international assistance to be harnessed for improving safety preparedness and prevalent maintenance practices.
- Key railway public sector enterprises including Ircon International Limited (IRCON), Indian Railway Finance Corporation Ltd. (IRFC) etc. will be listed on stock exchange.
- 25 stations have been identified for redevelopment in 2017–18.
- As part of accounting reforms, accrual based financial statements to be rolled out by March 2019.
- Other key announcements:
  - Service charges on bookings of railway tickets through Indian Railway Catering and Tourism Corporation Limited (IRCTC) will be withdrawn.
  - In line with the Swach Bharat Abhyan, all coaches of Indian Railways will be fitted with bio-toilets by 2019.
  - Trains dedicated for pilgrimage and tourism will be launched.
  - Indian railways will implement end to-end integrated transport system for select commodities in partnership with private players.
  - 500 stations will be made differently abled friendly by providing lifts and escalator.
  - 'Coach Mitra', a single window interface, to register all coach related complaints and requirements will be launched by the ministry.
- 7,000 stations are proposed to run on solar power in the medium term, with work on 300 stations already under progress

"Budget announces certain progressive steps towards provision of end to end transport solutions such as partnership for last mile connectivity for select commodities, and customization of infrastructure and practices for transport of perishable goods, which are expected to enhance Railways' share in freight transportation. Listing of PSEs IRCON, IRFC, and IRCTC could unlock value for IR and help improve availability of finances. However key to success lies in implementation of these steps."

Other recent policy updates

- Ministry of Railways has identified 9 themes for it to pursue and ensure growth of Indian Railways in future. These are infrastructure upgradation, passenger experience, preferred freight carrier, non-fare revenue enhancement, zero fatality, modernization by digitization & cutting edge technology, organizational culture, cost focus and sustainability. Dedicated units / teams have been set up in the railway board to pursue some of these themes, which include transformation cell, mobility directorate, and non-farebox revenue directorate.
- Mission Raftaar was launched during the 2016-17, with the objective of doubling of average speed of freight trains, and increasing the average speed of all non-suburban passenger trains by 25 kilometre per hour (kmph) in next 5 years.
- Memoranda of Understanding (MoU) has been signed between Ministry of Railways and Governments of Haryana, Jharkhand and Odisha for "Formation of joint venture companies for development of railway infrastructure in these States'.
- Ministry is working on an executive order for establishing Rail Development Authority of India, which will be the regulator for determining tariffs. Meanwhile flexi fare system for Rajdhani, Duronto and Shatabdi trains has been introduced in September 2016.
- Proposal for setting up a World Bank – anchored fund of USD 5 billion is in progress, which will be used to fund financially viable railway projects. Draft cabinet note for the same has been circulated.
- Ministry of Railways launched the following policies during the current financial year to bolster the freight business of Indian Railways:
  - 'Liberalized Comprehensive Parcel Leasing Policy (CPLP)' and Liberalized policy on 'Parcel Cargo Express Trains (PCET)'.
  - Liberalized Station to Station Special Freight Rates policy.
  - Rationalized siding policy to ease the setting up additional private terminals.
  - Extension of the Automatic Freight Rebate Scheme in empty flow directions.

Aviation

Budget announcement

- The Airport Authority Act will be amended to enable monetisation of airport land.
- Operations and management for select airports in tier- II cities will be taken up on PPP mode.

Other recent policy updates

- The Government has finalized and released the National Civil Aviation Policy (NCAP) in June 2016. Under the NCAP, important aspects such as introduction of a Regional Connectivity Scheme, amendments to the 5/20 rule for international operations and aeronautical 'Make in India' have been outlined.
- The Government has eased Foreign Direct Investment (FDI) regulations, and has allowed 100% FDI under automatic route in Brownfield Airport projects. Furthermore, FDI limit for Scheduled Air Transport Service, Domestic Scheduled Passenger Airline and regional Air Transport Service has been raised from 49% to 100%, with FDI up to 49% permitted under automatic route and FDI beyond 49% through Government approval.
- To boost the growth of the civil aviation sector, Directorate General of Civil Aviation (DGCA) has proposed a new regulation on criteria for leasing of foreign registered aircraft by Indian operators for operation by Indian crew. This proposal, when accepted, will enable Indian operators to import foreign registered aircrafts and operate them on foreign registration with Indian crew.

"Amending the Airport Authority Act to allow for land monetization is a step which is in the right direction and will help boost the non-aeronautical revenues of the airports and improve viability of the airports."

"Awarding of operations and management of airports in tier II cities on PPP mode is a welcome move as it will help create a roadmap for private sector participation in airports in the country and help in improving the operations at these airports."

Ports & Shipping

Budget announcement

There is no major announcement.

Other recent policy updates

- The Government released the perspective plan and roadmap for the Sagarmala program, the flagship maritime program focusing on development along 4 thematic area viz. port modernization & new port development, port connectivity for efficient evacuation, port led industrialization and coastal community development. The perspective plan envisages over 150 projects across these areas and infrastructure investment mobilization of INR 4,000 billion.
- Major Port Authorities (MPA) Bill, 2016 approved by the Cabinet. The bill proposes wide spread changes functioning of major ports in the country and promises greater autonomy to them. It places emphasis on:
  - Lean governance structure and sound corporate governance & accounting practices for the major ports.
  - Authority to major ports to fix & regulate the tariff.
  - Rationalization of role of Tariff Authority for Major Ports (TAMP) and constitution of Adjudicatory Boards to address issues arising from the earlier tariff guidelines and orders issued by TAMP.
- Berthing Policy for dry bulk cargo introduced for improving competitiveness of major ports.
- The Government announced waterfront and associated land policy which deals with grant of concession to port dependent industries for setting up dedicated facilities at major ports.
- Merchant shipping bill, 2016 approved by Cabinet The bill focuses on promotion on coastal shipping and welfare of sea farers.

Water & Sanitation

Budget announcement

- The funding for Long Term Irrigation Fund (LTIF) set up in NABARD under PMKSY, for funding and fast tracking the implementation of incomplete major and medium irrigation projects, has been allocated an additional corpus of INR 200 billion, thus doubling the corpus to INR 400 billion.
- A new Micro irrigation fund with a corpus of INR 50 billion has been announced
- A new sub mission under the National Rural Drinking Water Programme (NRDWP) announced to provide safe drinking water to over 28,000 arsenic and fluoride affected habitations in the next four years.
- In order to link water interventions with sanitation, piped water supply will be prioritized in ODF habitations.

Other recent policy updates

- Government continues to increase coverage and providing piped drinking water supply to across the country through its flagship programs of National Rural Drinking Water Supply Program and Atal Mission for Rejuvenation and Urban Transformation.
- The Swachh Bharat Mission - urban and gramin, are being implemented across the country with a target to achieve basic sanitation facilities across the country by 2019.
- Large scale private sector participation is envisaged in not only in drinking water supply and sanitation sectors but also in water resources management.
- Integrated Ganga conservation mission, "Namami Gange", with an outlay of INR 200 billion (USD 3 billion) envisaged to be taken up on PPP mode.
- National mission for clean Ganga authority created under River Ganga (Rejuvenation, Protection and Management) Authorities Order, 2016.
- The Pradhan Mantri Krishi Sinchan Yojana (PMKSY), with an outlay of INR500 billion (USD7.3 billion), is being implemented from 2015 and is focused on improving water use efficiency in the irrigation sector and increasing the command area under irrigation.
- The Ministry of Water Resources has come up with a draft National Water Framework Bill, 2016 and model bill for the conservation, protection, regulation and management of groundwater in May 2016. These bills, when enacted, are likely to bring in the much needed uniformity in water policy across the country.

"The Sustainable Development Goal 6 aims at ensuring 'access to water and sanitation for all'. However, the financial allocations to rural drinking water program (NRDWP), under the Union Budget 2017-18, fall significantly short of the requirements in the sector. Nevertheless, the enhanced allocation for the sanitation to achieve the objective of Swachh Bharat is a welcome move."

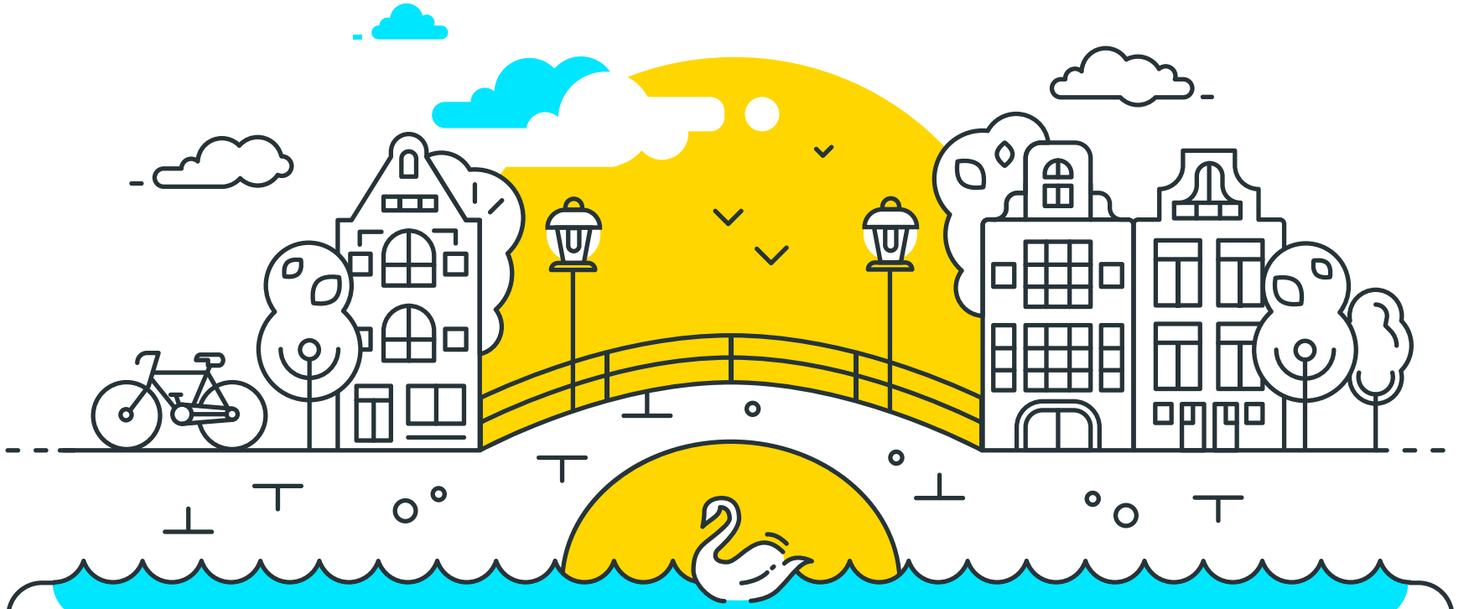
Urban infrastructure

Budget announcement

• A new 'Metro Rail Policy' will be announced with focus on innovative models of implementation and financing, as well as standardisation and indigenisation of hardware and software. The new policy will be enacted by rationalising the existing laws.

Other recent policy updates

- Policy on Value Capture Financing (VCF):
  - Considering the massive investment requirements for development of urban infrastructure, India's first VCF policy has been framed by the Government.
  - This policy would help the government recover some value generated by public infrastructure investments for private landowners.
  - The government has identified target agencies to adopt VCF as a financing tool include state governments, central ministries of urban development, railways, road transport, department of industrial policy and promotion, power and shipping.
- Green Urban Mobility Scheme (GUMS):
  - The Central Government has announced GUMS policy to encourage private investments in climate friendly and sustainable public transport systems like Metro rail, Non-motorised Transport and other low carbon emitting systems in urban areas.
  - This scheme is being considered for implementation in cities each with a population of 500,000 and above and all capital cities, Central assistance of about INR 250 billion is estimated to be required which would in turn trigger private investments to meet the resource needs, over the next five years.



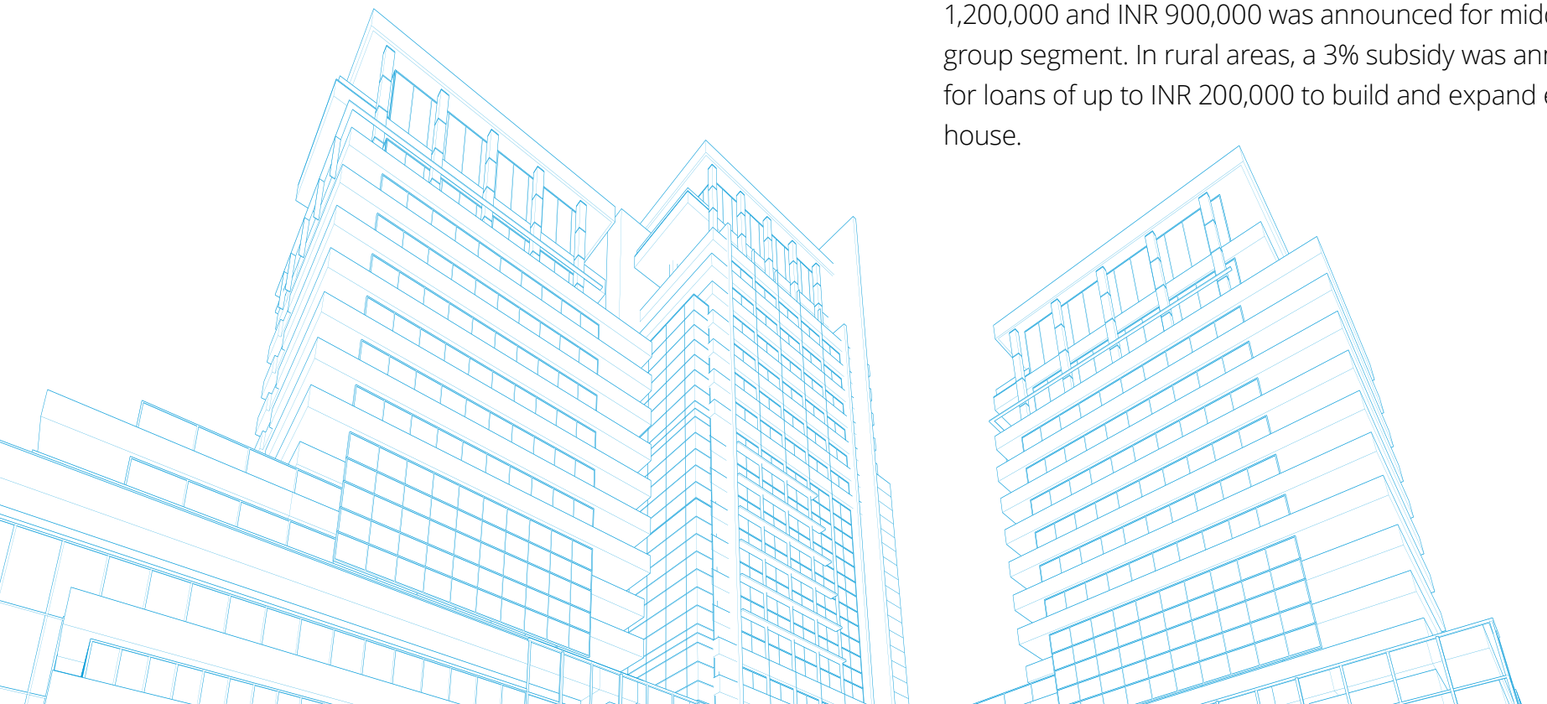
Real Estate & Affordable Housing

Budget announcement

- Affordable housing accorded infrastructure status enabling priority lending from banks.
- The National Housing Bank will be provided with funds for refinancing of debt worth INR 200 billion.
- The allocation under Pradhan Mantri Awas Yojana has been increased to 230 billion during 2017-18 to enable completion of 10 million houses by 2019 for the homeless and those living in kutcha houses.

Other recent policy updates

- To protect the rights and interests of consumers and promotion of uniformity and standardization of business practices and transactions in the real estate sector, Real Estate (Regulation and Development) Act (RERA), 2016 was introduced.
- Real Estate Rules were also notified for union territories and states without legislature.
- Interest subsidy of 3% and 4% for housing loans of up to INR 1,200,000 and INR 900,000 was announced for middle-income group segment. In rural areas, a 3% subsidy was announced for loans of up to INR 200,000 to build and expand existing house.
- For rural housing, Government launched Pradhan Mantri Awas Yojana – Gramin (PMAY - G) aimed at providing 10 million pucca houses in rural areas.
- The Benami Transactions (Prohibition) Amendment Act, 2016 has been introduced.
- FDI norms for investment in construction and development sector eased by removing caps applicable to minimum capitalization and land requirement.
- Draft notification to relax environment clearance requirements for housing and real estate projects issued by Ministry of Environment & Forests (MoEF).



The continued attention "affordable housing" has received in this Budget too is a welcome move. The inclusion of affordable housing in the Harmonized Master List of Infrastructure Sub-sectors is going to provide the much needed impetus for the private sector to actively take up the sector.

Logistics & SEZ

Budget announcement

- Trade Infrastructure for Export Scheme (TIES), a Central scheme with a focus on export infrastructure, will be launched in 2017-18.
- Government will implement a specific programme for the development of multi-modal logistics park with multi modal facilities.

Other recent policy updates

- The Government approved the re-designation of the Delhi-Mumbai Industrial Corridor Project Implementation Trust Fund as National Industrial Corridor Development & Implementation Trust (NICDIT) — the apex body to oversee development of all industrial corridors across the country.

PPP & Financing

Budget announcement

- Amendment to the Arbitration and Conciliation Act 1996 is proposed for a mechanism for dispute resolution in the Sector.

Other recent policy updates

- There was no major announcement.

"The announcement of MAT credit being allowed to be carried forward up to a period of 15 years instead of 10 years shall prove to be beneficial for the PPP projects of the Roads & Highways sector which generally have a longer concession period"

"The focus on infrastructure development is in line with the government's vision. An infrastructure demand and supply gap has hampered the country's growth and withheld some foreign players to operate in the country. Higher spending in this sector, along with steps to revive stuck PPP projects is likely to address a number of longstanding issues."

Direct Tax

- Corporate tax rate for Financial Year ('FY') 2017-18 remains unchanged @ 30% plus surcharge and cess (except for Small & Medium Enterprise (SME) companies stated below). The proposed effective maximum marginal rate for Indian companies is 34.61% and for foreign companies is 43.26%.
- Corporate tax rate for FY 2017-18 proposed to be reduced to 25% plus surcharge and cess for SME companies with turnover or gross receipts not exceeding INR 500 million in the FY 2015-16. The proposed effective maximum marginal rate for Indian companies would be 28.84%.
- General Anti Avoidance Arrangement Regulations continues to come into effect from FY 2017-18.
- Determination of residency of foreign companies on the basis of Place of Effective Management applicable from assessment year 2017-18.
- In line with the Base Erosion and Profit Shifting plan, thin capitalisation norms have been introduced. Where debt has been issued by non-resident associated enterprises, the maximum amount of interest deductible would be 30% of Earnings before interest, tax and depreciation. The rule also seeks to cover soft lending / guarantee by associated enterprises.
- Period for getting benefit of long term capital gain in case of immovable property (being land or building or both) is proposed to be reduced from 3 years to 2 years.
- Base year of indexation for the purpose of computing capital gain tax is proposed to be shifted from 01 April 1981 to 01 April 2001.
- The concessional withholding tax rate of 5% in respect overseas borrowing has been extended from 1 July 2017 till 1 July 2020. The benefit of concessional withholding tax rate is extended to Rupee Denominated (Masala) Bonds too.
- Carry forward and set-off of tax credit in respect of Minimum Alternate Tax and Alternate Minimum Tax credit extended from 10 years to 15 years.
- Payment in cash above INR 10,000 (earlier limit INR 20,000) to a person in a day shall not be allowed as deduction.
- Transactions of more than INR 0.3 million in cash in a single day or from a single party or relating to one event prohibited.
- Conversion of preference shares of a company into equity shares shall not be regarded as transfer for the purpose of capital gains.
- Cost of acquisition of shares of Indian company in the hands of resulting foreign company shall be the same as in the hands of demerged foreign Company.

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For Joint Development Agreement signed for development of property, the liability to pay capital gain tax will arise in the year of completion of the project.

- Provisions of Minimum Alternate Tax rationalised to provide the framework for computation of book profits for Indian Accounting Standard compliant companies in the year of adoption and thereafter.
- Scope of specified domestic transaction reduced to exclude transactions relating to payment of expenditure made to a person referred to in under section 40A(2)(b).
- Introduction of Secondary Adjustment by re-characterizing the primary transfer pricing adjustment, as a deemed advance made by the assessee to the associated enterprise in case the excess money is not repatriated to India within the prescribed time, leading to imputation of notional interest.
  - The primary transfer pricing adjustment could result either from suo-moto action (by assessee), or as made by the assessing officer (accepted by the assessee), or under an advance pricing agreement, or as per the safe harbour rules, or as a result of resolution by way of mutual agreement procedure.
  - No secondary adjustment shall be made if the amount of primary adjustment does not exceed INR 10 million rupees, or the primary adjustment pertains to assessment year 2016-17 or before.

Conditions prescribed for claiming 100% deduction for profits to an undertaking engaged in developing and building affordable housing project relaxed:

- Project can be completed within 5 years (instead of 3 years)
- Size of residential unit shall be measured by taking into account the carpet area and not the built-up area
- Restriction of 30 square meters shall not apply in case of residential units located within a distance of 25 kms from the municipal limits of the Chennai, Delhi, Kolkata or Mumbai.

Indirect Taxes

- Merit rate of customs duty and excise duty as well as standard rate of service tax has remained unchanged.
- Research & development cess, as being levied on import of technology, is proposed to be repealed.
- Service tax exemption proposed on Viability Gap Funding (VGF) payable by Government to the selected airline operator for the purpose of transport of passengers, by air, embarking from or terminating in a Regional Connectivity Scheme (RCS) airport. Exemption is granted for a period of one year from the date of commencement of operations of the RCS as notified by Ministry of Civil Aviation.
- Person-in-charge of a conveyance that enters or departs India or any other person, as may be specified by the Central Government is required to deliver to the customs officer:
  - Passenger and crew arrival / departure manifest before arrival / departure in the case of an aircraft or a vessel and upon arrival / departure in the case of a vehicle;
- Passenger name record information of arriving / departing passengers.
- BCD on Reverse Osmosis (RO) membrane element for household type filters is being increased from 7.5% to 10%.
- Service Tax Valuation Rules are being amended with effect from 1 July 2010 to clarify that the value of service portion in works contract shall not include value of property in such land or undivided share of land.

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