Deloitte.

Pre-Budget Expectations Survey

Corporates

Preface

2017 was in many ways a defining year for the Indian economy. Preceded by the completely unexpected move of demonetization, it finally brought to life the much discussed GST. However the change did not stop there. Many Indian companies prepared accounts using Ind AS, got ready for newer compliances under BEPS. With so many regulatory changes, the business landscape also had to deal with rising economic uncertainty as oil prices moved up, Indian economy grew at a slower pace and US saw its biggest tax reform take shape. With elections slated for 2019, we asked Indian businesses as to what their expectation was from the last full budget of this government.

We got several interesting responses from approximately 120 professionals, which have been discussed in this report. On the whole, the survey has a mood of cautious optimism with the Indian businesses enthusiastic about the reforms but wanting to have an environment of easier compliances and audit processes.

Economy Outlook

Economy snapshot

GDP shows a move downwards

GDP growth at 6.3% in 2QFY18 (AE: 6.5% FY 2017-18)

CAD remains relatively narrow

CAD at -1.2% of GDP in 2QFY18

Monetary policy in neutral mode

Repo rate cut from 6.25% to 6% in Aug’17

Foreign fund inflows have improved

FDI inflow of USD~43.5 billion in FY17, added USD 25.4 bn as of 2QFY18

Fiscal Deficit, likely to overshoot target

Could stretch beyond 3.2% of GDP in FY18

Inflation levels move upwards

CPI at 5.2% in Dec’17

INR expected to weaken through the year

At 63.92, likely to move towards 66 per US$

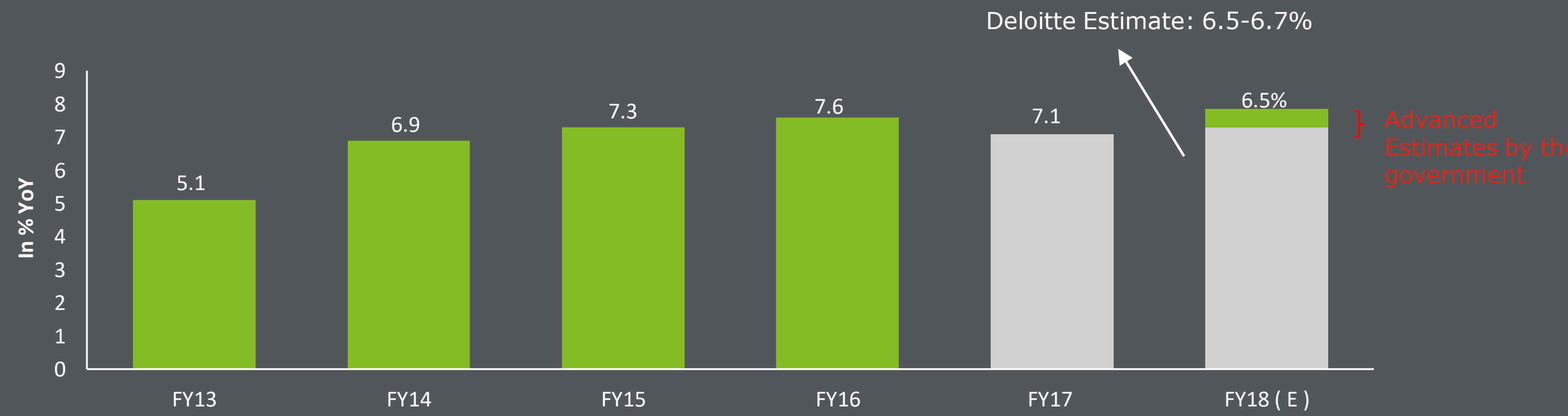
Exports showed a movement upwards

Exports rose by 12.4% in Dec’17

GDP numbers

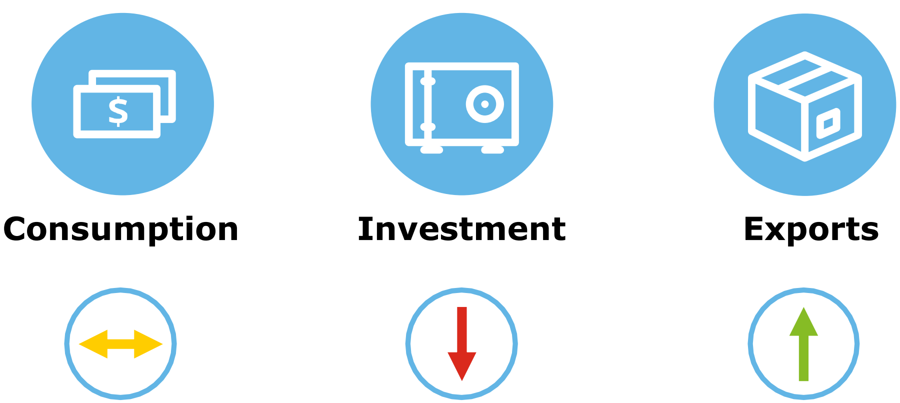
Growth expected to pick up over the next quarters

GDP growth rate



Source: Central Statistical Organization & RBI

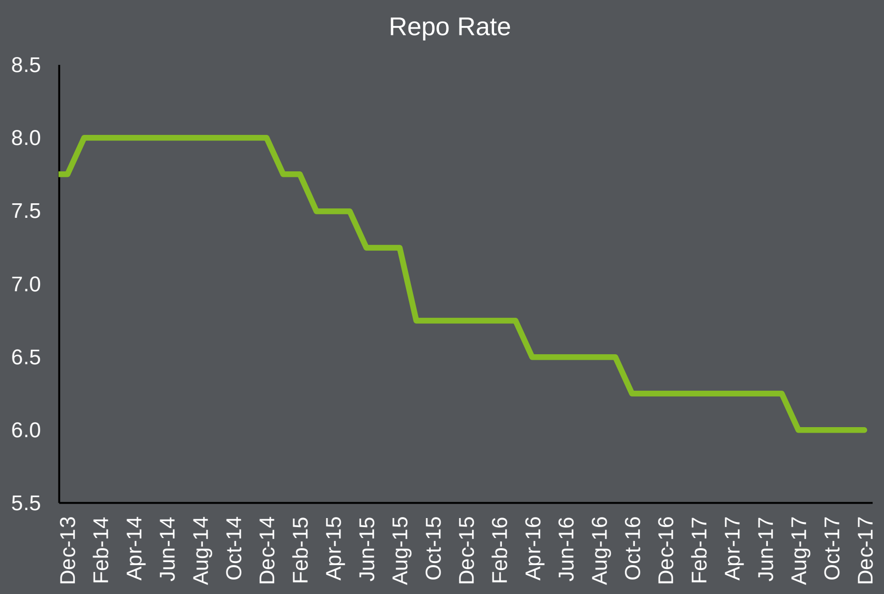
GDP growth likely to dip below 7% and come within the 6.5-6.7% range due to a slew of disruptive reforms undertaken in the recent years.



Monetary Policy and Interest Rate

Balancing Inflation and Growth

- The RBI during its 5th bi-monthly policy announcement decided to keep the repo rate unchanged at 6% in Dec’17 taking note of the upside pressures from food and fuel prices.
- Important to note that the RBI has a CPI target range of 4% (+/-) 2% for the next five years.
- Rising international commodity prices and expectations of improving demand levels are expected to put pressure on inflation
- With the US Fed likely to go in for another couple of rate hikes in the current calendar year, expect the RBI to stay put on rates for the remainder of FY 17 - 18.



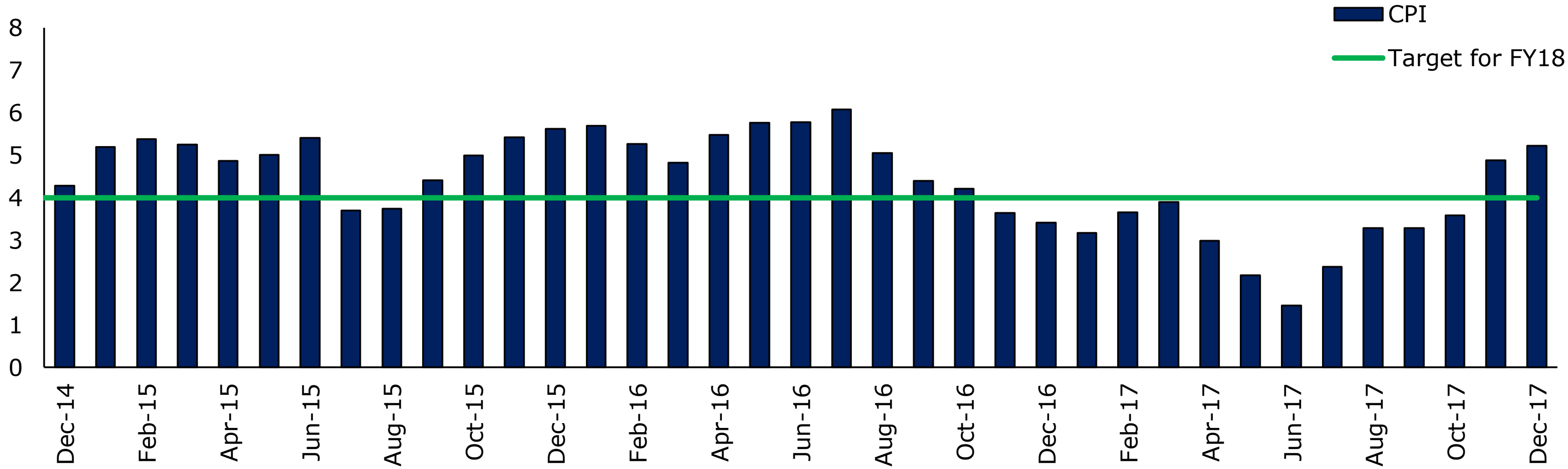
Source: CEIC, Deloitte

Monetary Policy and Interest Rate

Balancing Inflation and Growth

- Consumer price inflation picked up pace in Dec’17, rising 5.2% as compared to an increase of 4.9% in Nov’17. This marks the fifth consecutive month of spike in inflation numbers.
- Expected increase in crude oil is expected to further fuel inflation in the coming months. That said, inflation is likely to move down during the second half of calendar year 2018 as the adverse base effect wanes.

Consumer Price Index (y-o-y, %)

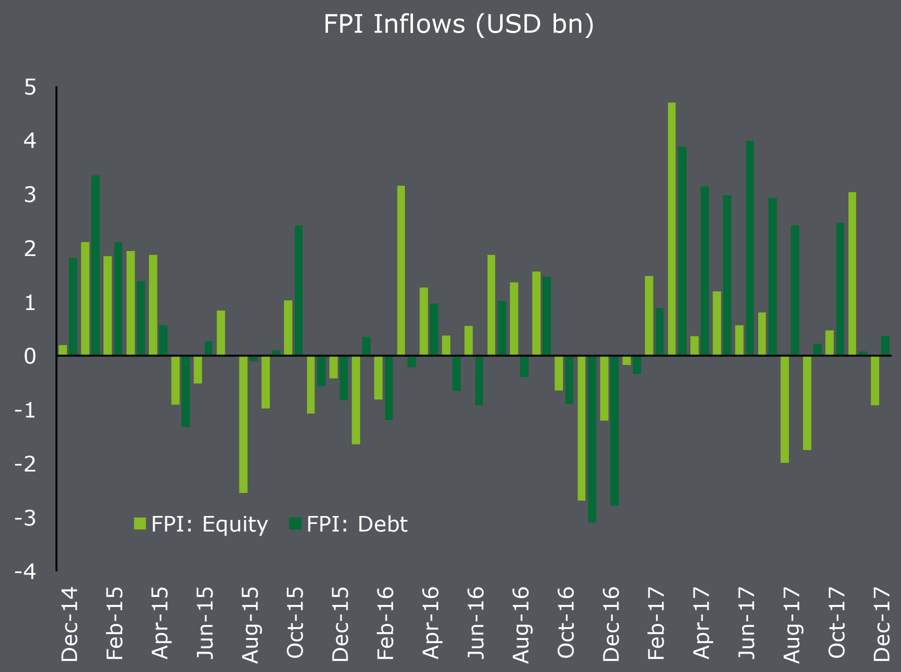


Source: CEIC, Deloitte

External sector

FPI investments to remain volatile

- Debt and equity inflows from foreign investors have continued to show an uptick following positive investor sentiment since the previous Budget, backed by improved clarity in FPI taxation, supported by Moody's upgrade.
- Equity markets slowed since March'17, likely on account of the effects of demonetization. Capital markets likely have been propelled by government's bank recapitalization plan and surge in India's ranking in the World Bank's ease of doing business index.
- The likelihood of the Fed raising rates in FY 18 – 19 also led to some rebalancing of portfolios
- Going forward, expect inflows to be volatile while still positive as growth picks up

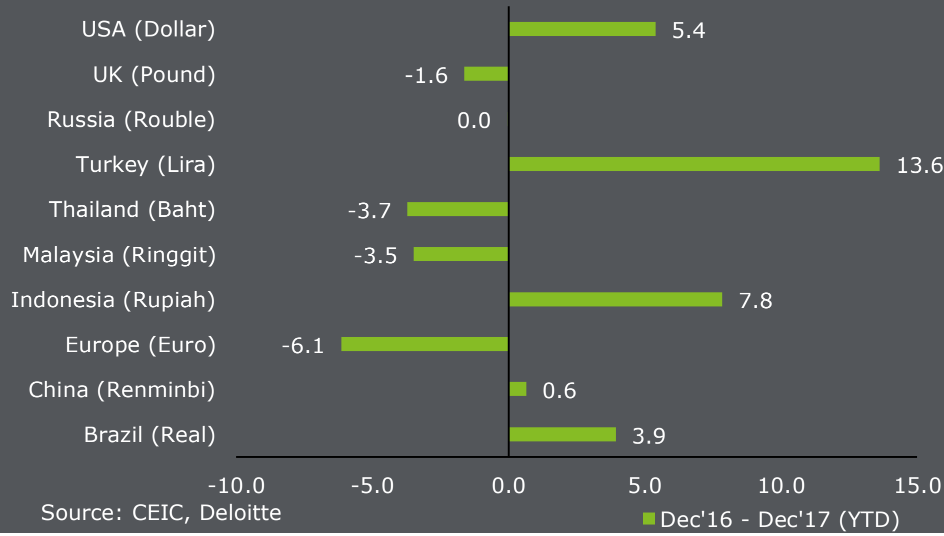


Source: CEIC, Deloitte

The Indian Rupee

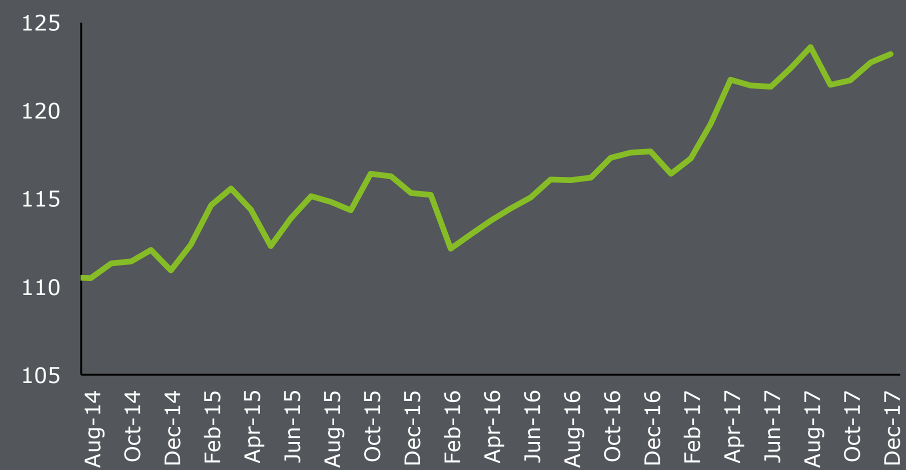
Likely weakness in store

Performance of INR against major global currencies (%, YTD)



Source: CEIC, Deloitte

Real Effective Exchange Rate (Export based weight)



Source: CEIC, Deloitte

- The INR has appreciated since the beginning of the year and has gained further to 63.7 to the USD as on 19 Jan 2018.
- While the currency has also appreciated against that of Indonesia, Brazil, and Turkey, it depreciated against the currencies of peer nations like Thailand, and Malaysia.
- REER above 100 shows that the INR is still overvalued at current levels.
- Expect the INR to remain around current levels in the near term and depreciate over the course of the year
- Going ahead, talk of the Federal Reserve raising rates along with structural issues could lead to some depreciation

Expect INR to remain vulnerable to short term flows. Likely to depreciate over the course of the year

World Bank Ease of Doing Business Rankings

Rankings across segments

- Indian made impressive strides in the latest "Doing Business" report and was among the 10 economies that improved the most in the areas measured by Doing Business.
- Highest rank was scored in terms of protecting minority investors. However ranking worsened in registering property.
- India was among the economies that implemented the highest number of business regulation reforms in 2016/17, with eight reforms each.
- The method for obtaining a building permit has been made faster by implementing an online Single Window System for the approval of building plans.
- Access to credit has also been improved by amending the rules on priority of secured creditors and adopting a new insolvency and bankruptcy code.

Ease of Doing Business Rankings

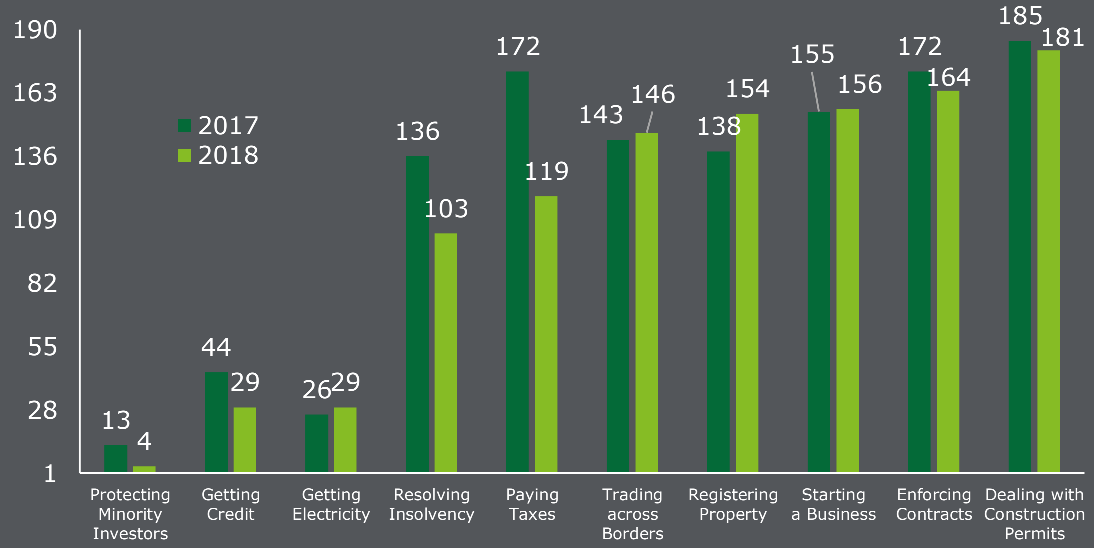
Source: CEIC, Deloitte

World Bank Ease of Doing Business Rankings

Rankings across segments

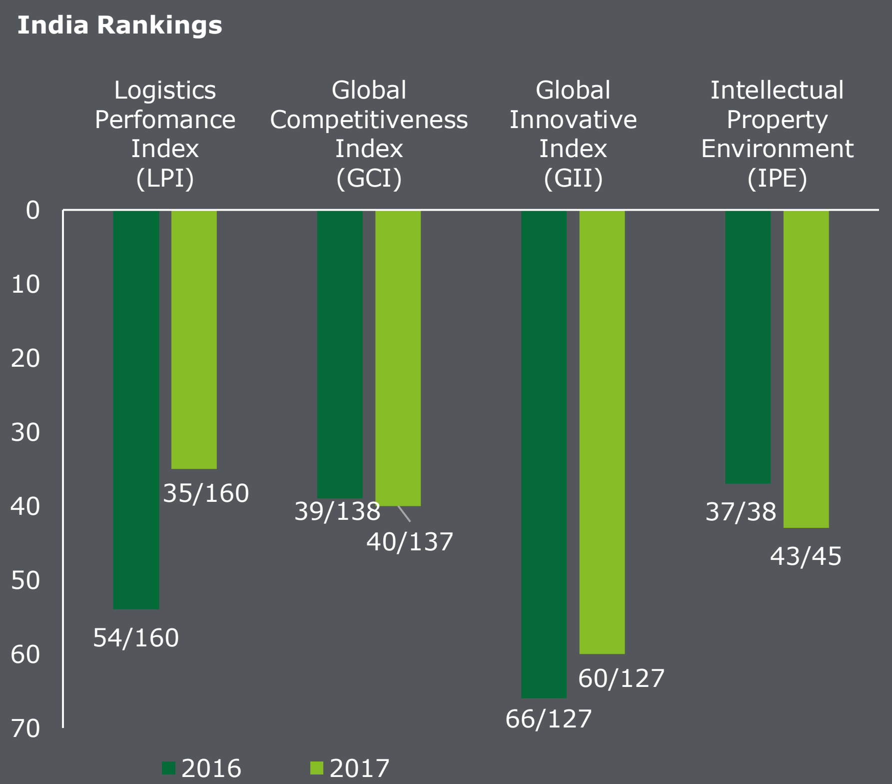
- In India, inefficient licensing and size restrictions have led to misallocation of resources and have reduced total factor productivity (as per a study)
- Removing licensing restrictions is expected to raise total factor productivity by an estimated 40-60%.
- The Indian economy continues to face procedural barriers to starting a business. Lengthy and costly regulations have prevented startups from entering the formal sector.
- India's ranking also slipped in trading across borders as well as getting electricity connections.

Rankings across Segments (World Bank-2018)



India Rankings across key indicators

Logistics and Innovation Index show improvement



Source: CEIC, Deloitte

*Logistics Performance for 2016 and 2014

LPI India remains the most competitive economy in South Asia and the drop in ranking came due to change in methodology. The score improved largely across infrastructure (66), education & training (75) and technological readiness (107)

GCI Improvement in India's LPI which measures international supply chain efficiency, has been enabled by programmes such as Make in India, and improvements in infrastructure

GII India has been ranked the top exporter of information and communication technology (ICT) services. It performed well across infra, business sophistication, knowledge & technology outputs.

IPE India remains near the end in intellectual property index as patentability for computer-implemented inventions remains a challenge, requirements remain outside international standards, coupled with lengthy pre-grant proceedings.

Major Changes over the last year: India

Fiscal Deficit
Increasing government spending along with slip in tax revenues is likely to push pressure on fiscal consolidation

Non-performing Loans
NPAs have seen a rise of 89.4% in 2016 and it is expected to rise in the coming 2 quarters as industries struggle to repay after demonetization announcement.

Demonetization
Announced in November 2016. Increased deposits and financial inclusion, disrupted informal sector

Goods & Services Tax
Unified about a dozen indirect taxes into a comprehensive, multi-stage, destination-based tax.

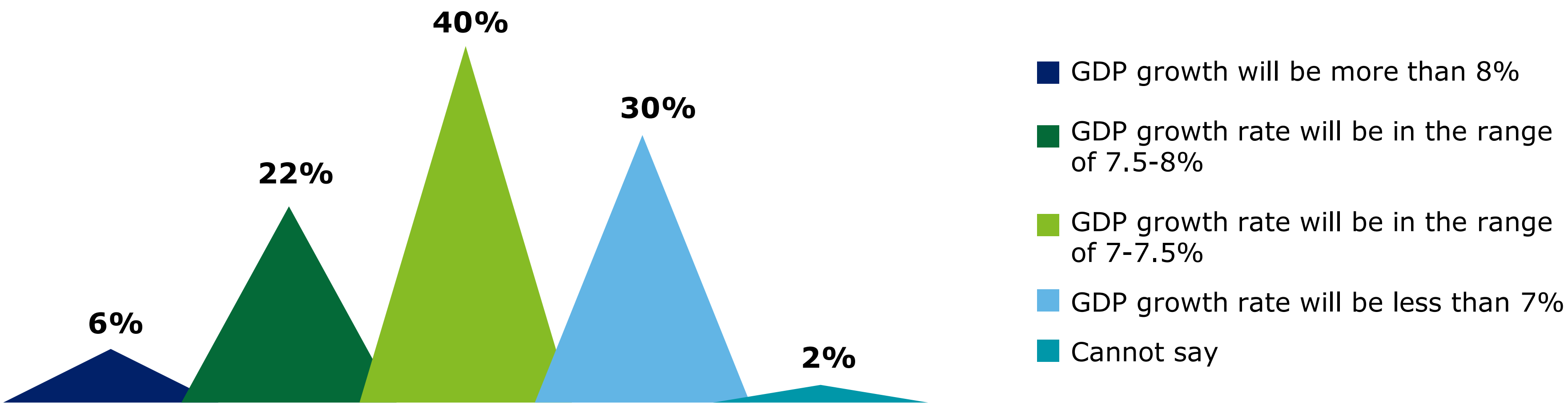
Ease of Doing Business
Ranked at 100 of 190 economies, India has moved up by 30 notches and performed exceedingly well in terms of expanding the economy

Foreign Investments
FDI came in at a steep USD 43.5 billion in FY17 and has continued to rise in the next 2 quarters indicating increased confidence amongst external investors.

What is your outlook on the Indian growth story for Jan-Dec 2018

For India, 2017 was regarded as a year of significant structural changes including GST, bank recapitalization plan and other infrastructure schemes. While demonetization and GST led to some market disruptions and subdued production sentiment, the economy has recently shown signs of recovery. Some of the indicators show a healthy growth including high liquidity, healthy capital inflows, and improving foreign exchange reserves. There are strong reasons to believe that consumer sentiment and investment demand might see a turnaround over the next year.

The survey also resonates a healthy growth outlook for the economy, with more than 50% of respondents expecting growth to remain above 7.0%.

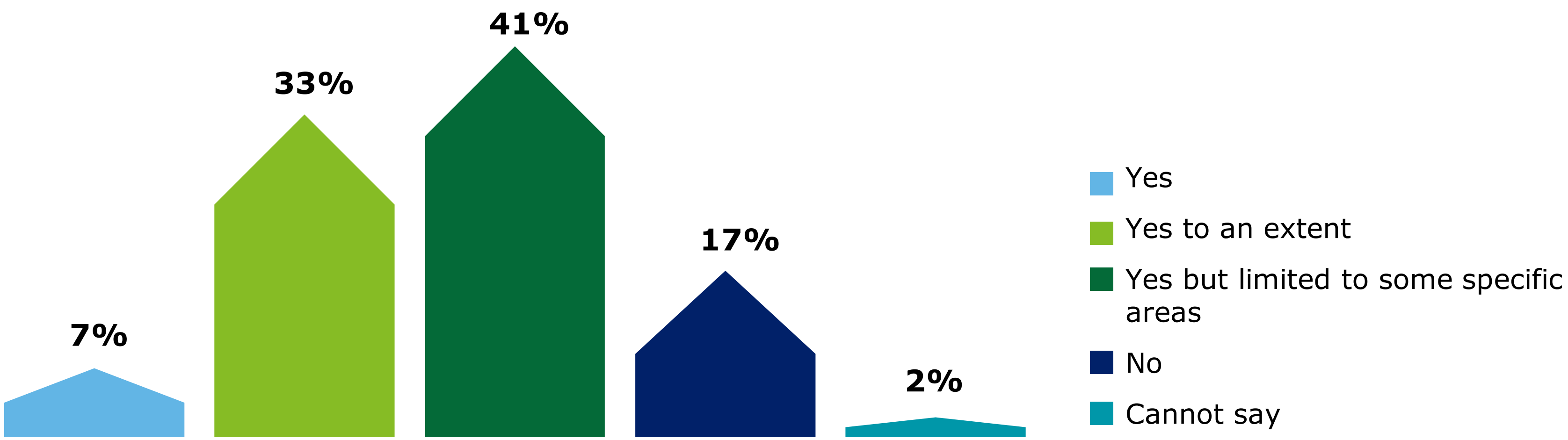


Do you feel that there is greater ease of doing business in India as compared to last year

For the first time since 2011, India recorded a dramatic jump of 30 places to attain 100th rank in World Bank's "Doing Business" index, indicating improvement in competitiveness and investment environment. This jump is expected to boost general economic sentiment. The future goals should focus on better performance across all parameters covered by the World Bank. This year, the increase was mainly on six of the 10 parameters.

This view is confirmed in the survey responses with almost 70% respondents saying that the improvement in ease of doing business is limited to some specific areas.

Further affirmative action on issues like infrastructural bottlenecks, swift implementation of investment projects, and restarting stalled projects would be critical.

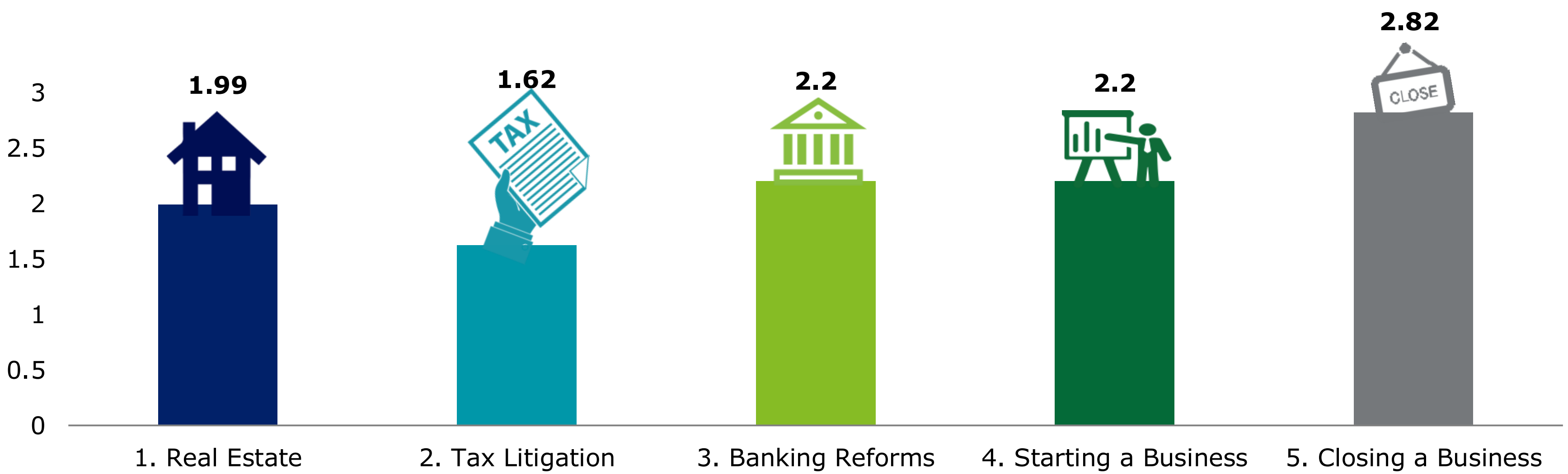


Please choose three areas, out of the following, where you feel that the GoI has to do much more reform (1 being most critical and 3 being least)

The US has enacted historical tax reforms. The Indian government has also announced setting up of a committee to examine and recommend changes in the direct tax framework.

That tax reforms are needed is also echoed in the survey where close to 50% of the respondents indicated that reform in tax litigation should be the most critical priority now for the government. This was followed by reforms in the real estate sector being considered as most vital.

Surprisingly, ease of closing a business was considered to be of least importance- perhaps indicating that businesses consider themselves to be in India for the long term!!

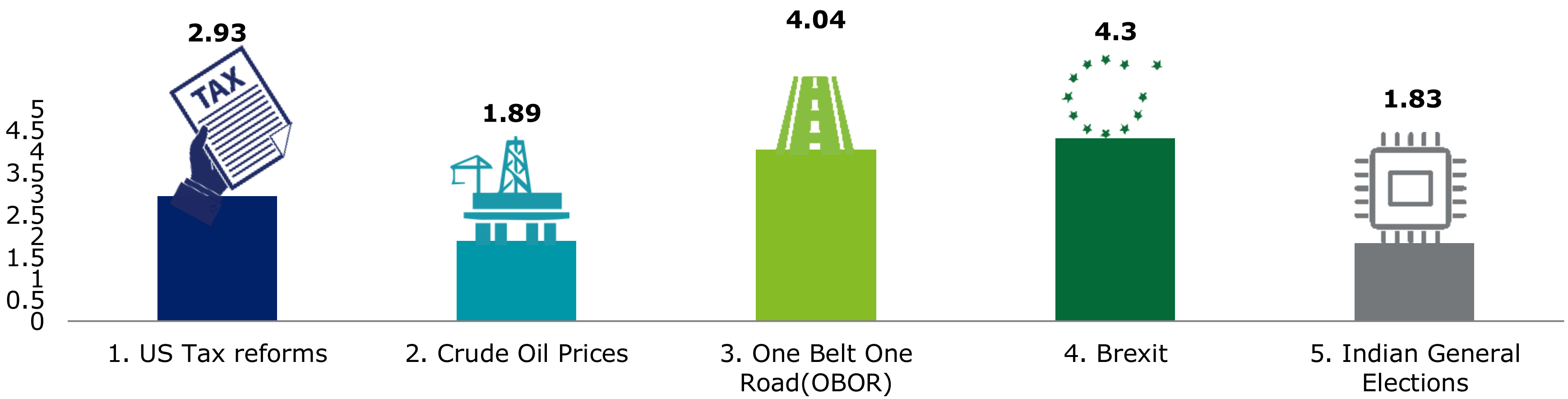


Please rate the following in terms of significant factors that will impact the Indian economy in the near term (1 being most significant and 5 being least)

There are a number of risks that Indian economy is likely to face in 2018. These include market uncertainty ahead of general elections, changes in the US and global economy, rise in crude oil prices as well increasing geopolitical risks.

Our survey respondents also agreed that these are the crucial risks. However they have ,in line with the expectations, downplayed the criticality of Brexit or OBOR significantly impacting the Indian economy.

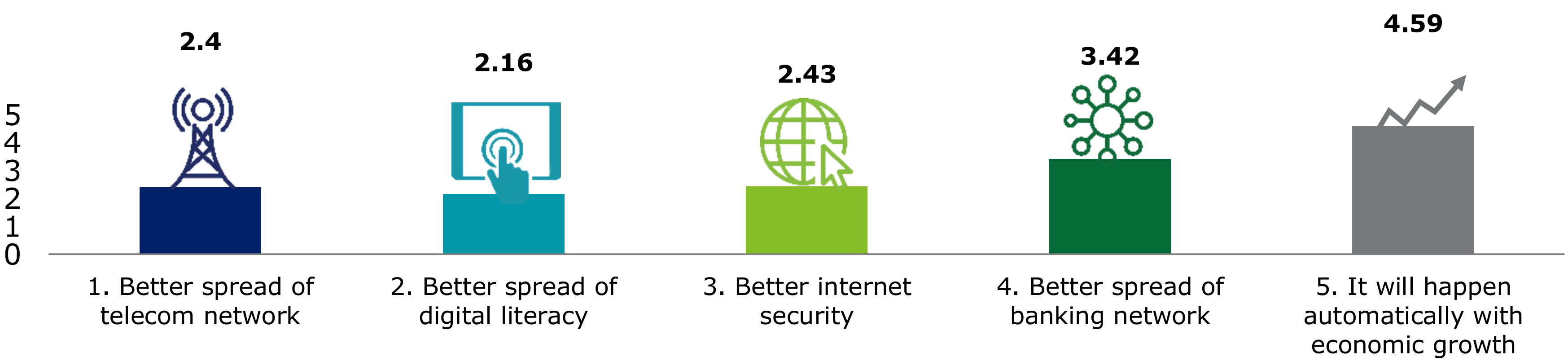
In fact, the responses here indicate that the upcoming general elections (45.5%) followed by rise in crude oil prices (37.2%) are the two import factors that will shape the economic trends in the coming year. The third important factor identified was the US tax regime (16.5%).



Which of the following factors would helping increasing digitization in the Indian economy (Rate 1 to 5 with 1 being the most critical factor and 5 being least)

India has seen a definitive tilt toward new innovative digital technologies as well as automation that are expected to redefine how businesses operate. This idea became even more prominent when last years demonetization drive left consumers with little cash and a few digital platforms. Indeed, government initiatives like Make in India and Digital India gained increased visibility. We believe that steps need to be undertaken for increasing awareness and penetration of digital platforms.

This view is also confirmed in the survey where maximum respondents were of the view that improvement in digital awareness, better telecom speed and enhanced internet security were the key factors that can improve the digital environment in India.

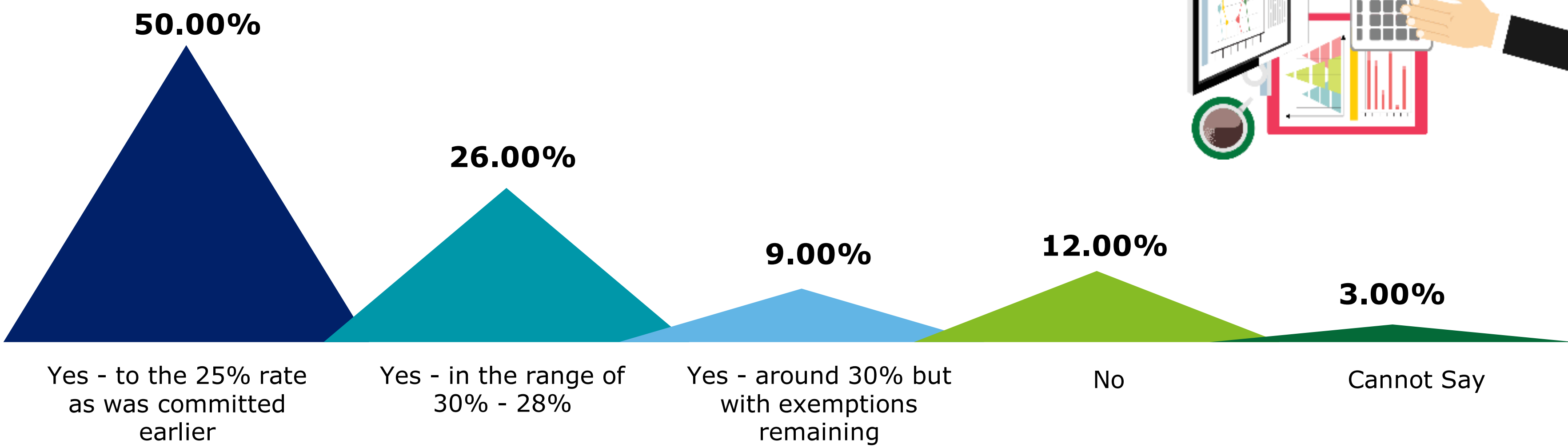


Corporate Tax

Do you expect the corporate tax rate to be reduced in the Budget 2018?

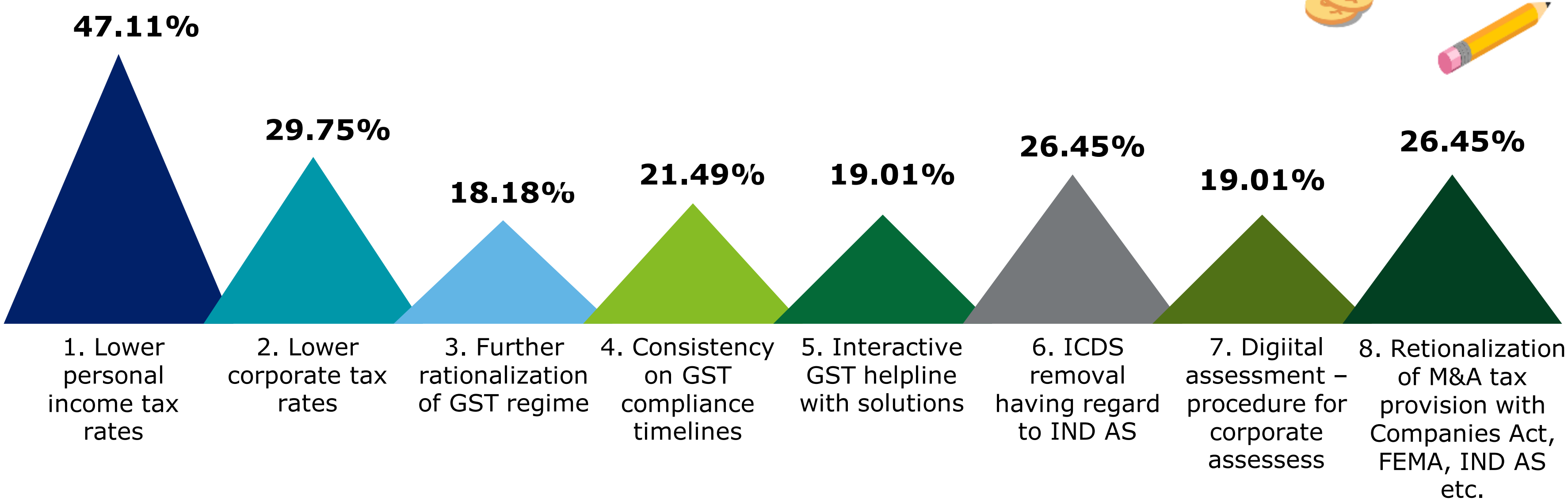
While presenting Union Budget, 2015, the Finance Minister made a significant proposal to reduce the corporate tax rate from 30 percent to 25 percent over the next 4 years. Subsequently, in Finance Act 2017, the Government extended the 25% tax rate only to the companies with turnover up to Rs 50 crores.

When asked about the expectations from the forthcoming Budget, half of survey respondents (50%) expected the corporate tax rate to be reduced to 25% applicable to all companies as was committed earlier. Given the strict measures taken by the government around curbing black money, it may be the appropriate time to reduce the tax rate.



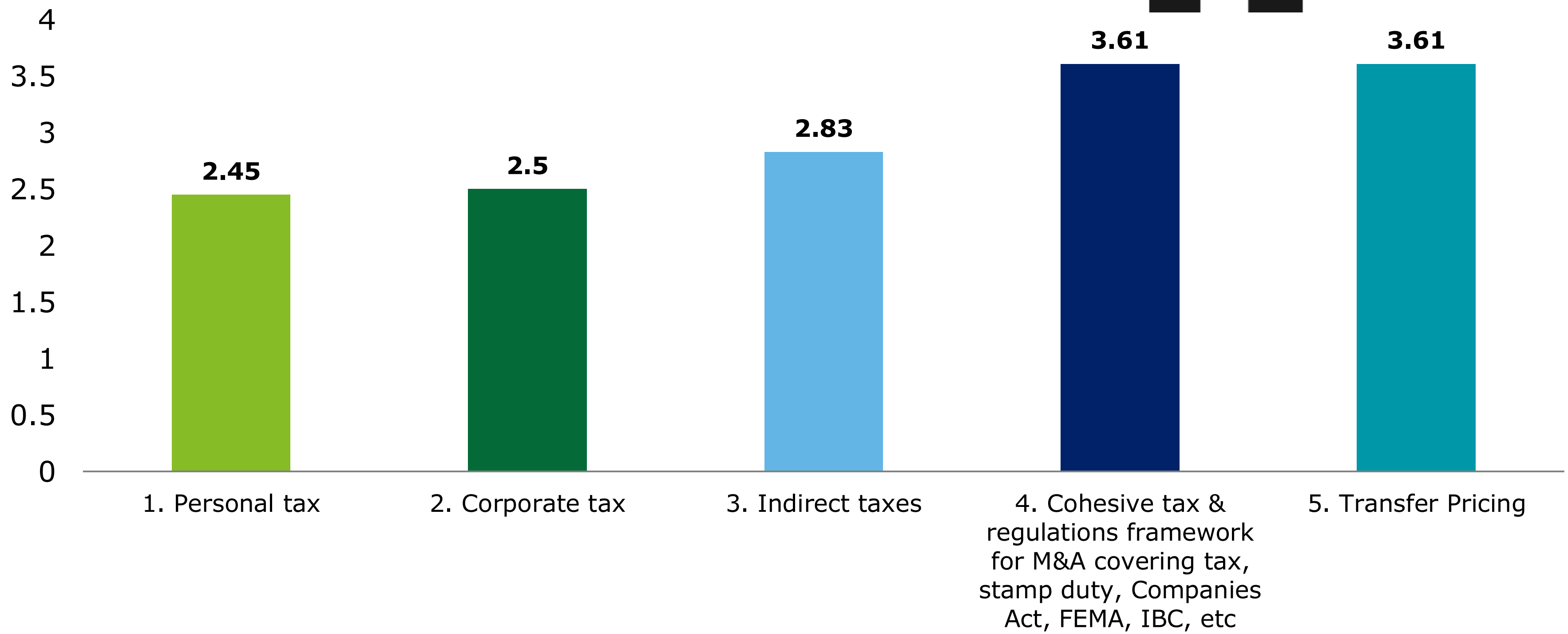
Please rank, in terms of priority, the following actions that you wish to see in the upcoming budget: (1 being top priority and 8 being least)

Among the various tax measures such as lower personal income tax rates, lower corporate tax rates, consistency on GST compliance etc., achieving ease of doing business, our survey respondents placed higher weightage on personal tax rate reduction (47.11%), followed by lower corporate tax rates (29.75%) and ICDS removal having regard to IND AS stands with rationalization of M&A tax provision with Companies Act, FEMA, IND AS etc (26.45%). Consistency on GST compliance and interactive GST helpline with solutions were the other two important measures pointed out by the respondents.



In your view, which area of the Indian tax regime is most in need of reforms/rationalization (Rate 1 to 5)

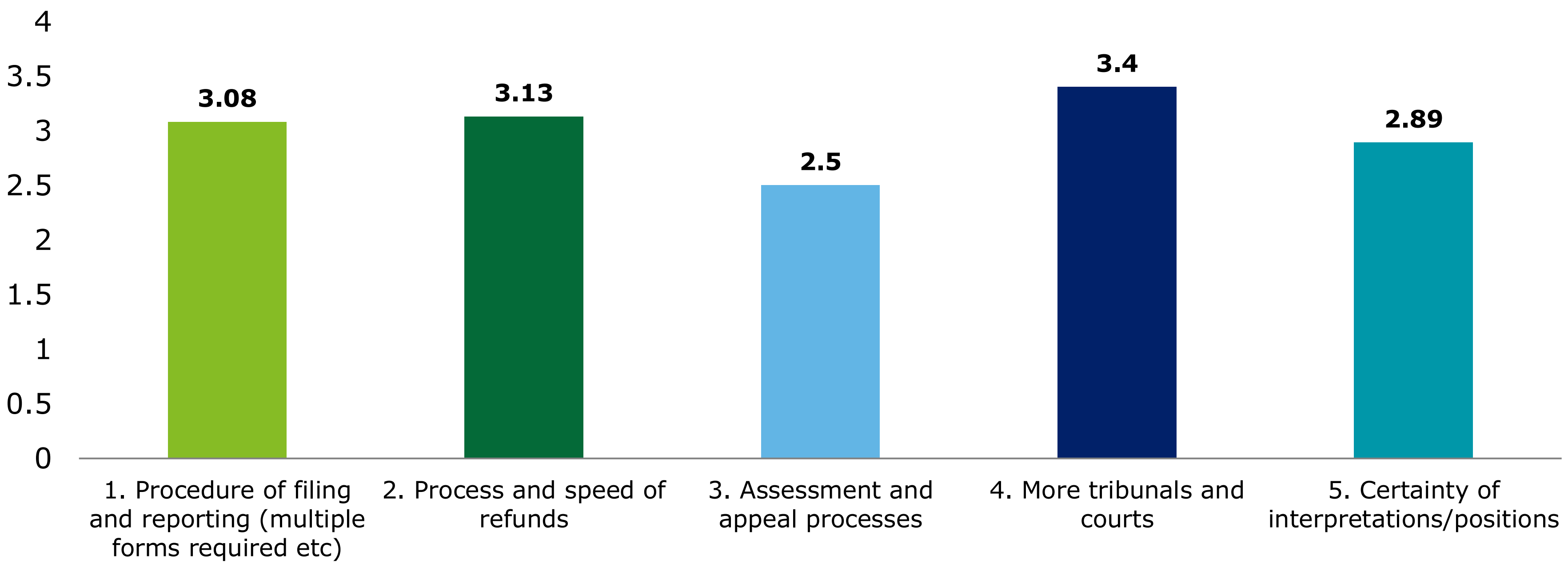
In respect of the areas of Indian Tax regime, reforms in the area of personal tax and corporate tax were given the highest priority followed by indirect taxes including GST, while reforms in the area of M&A, Companies Act, FEMA etc. along with transfer pricing were considered as least priority.



In your view, where is reform/ease most required in the Indian tax administration (Rate 1 being most critical and 5 being least)

Assessment and appeal process is considered to be the most critical reform in the Indian tax administration by our respondents, followed by certainty of interpretations/positions to bring down prolonged litigation.

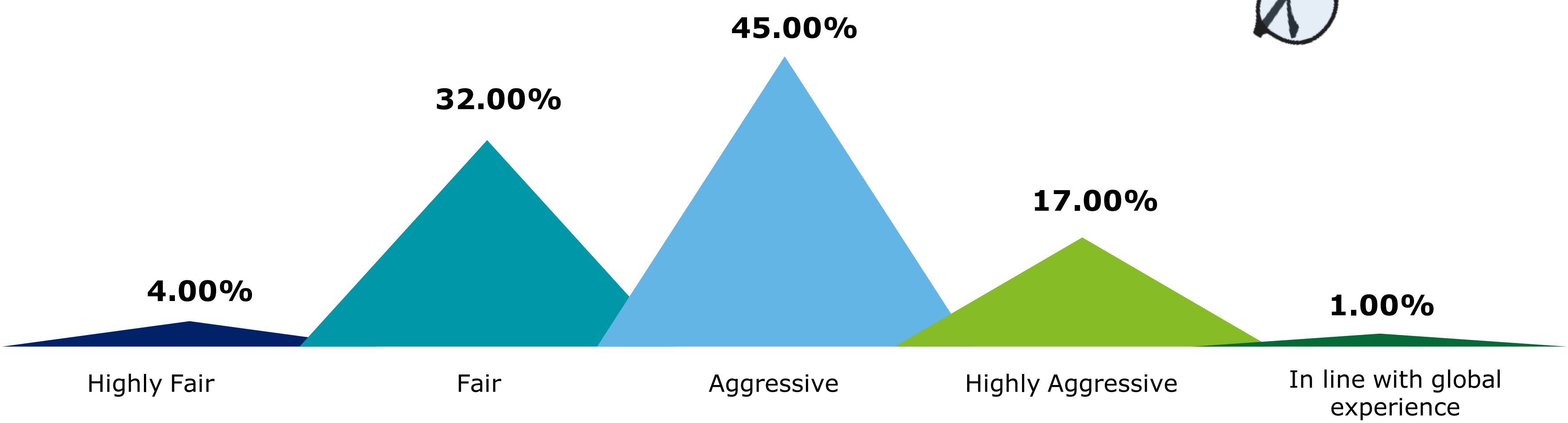
Speedy refunds along with more Income Tax Tribunals and Courts are areas where ease is required. Multiple forms are required in procedure of filing and reporting which is considered cumbersome and should be scrapped.



In your view, what is the global perception of Indian tax (choose one)

It is perceived globally by most of the respondents (45%) that Indian tax authorities are highly aggressive which has dented the image of India and reduces confidence of global investors to boost further investment in India.

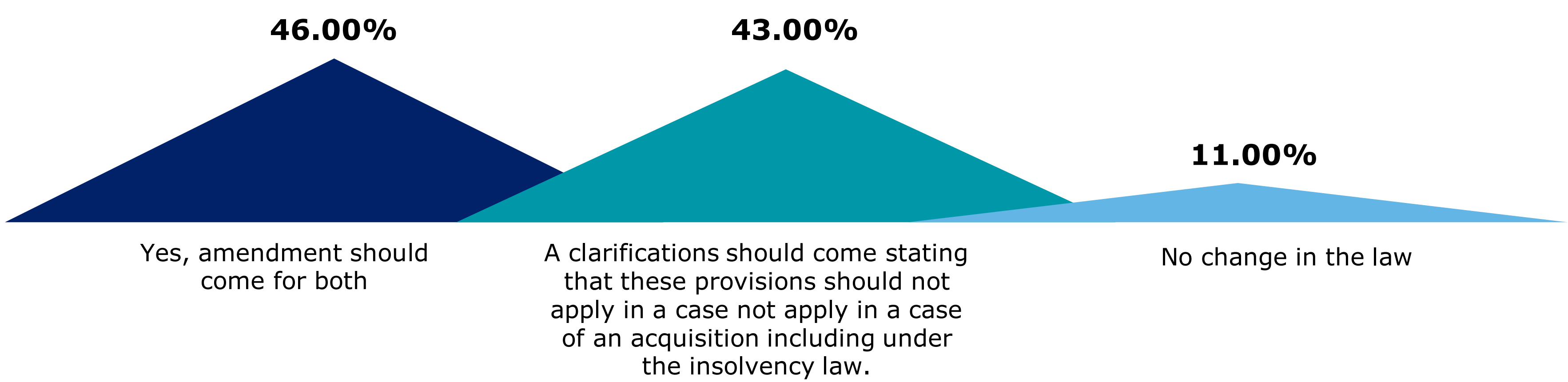
The fact that such a large percentage of the population believe this, clearly indicates that reform is needed in several areas from Indian tax perspective on a larger scale to boost investment in India.



The deeming provision under the Income Tax Act i.e. Sec 56 (2) (X), Sec 50 CA and MAT provision should be amended in a case of acquisition under insolvency law: (choose one)

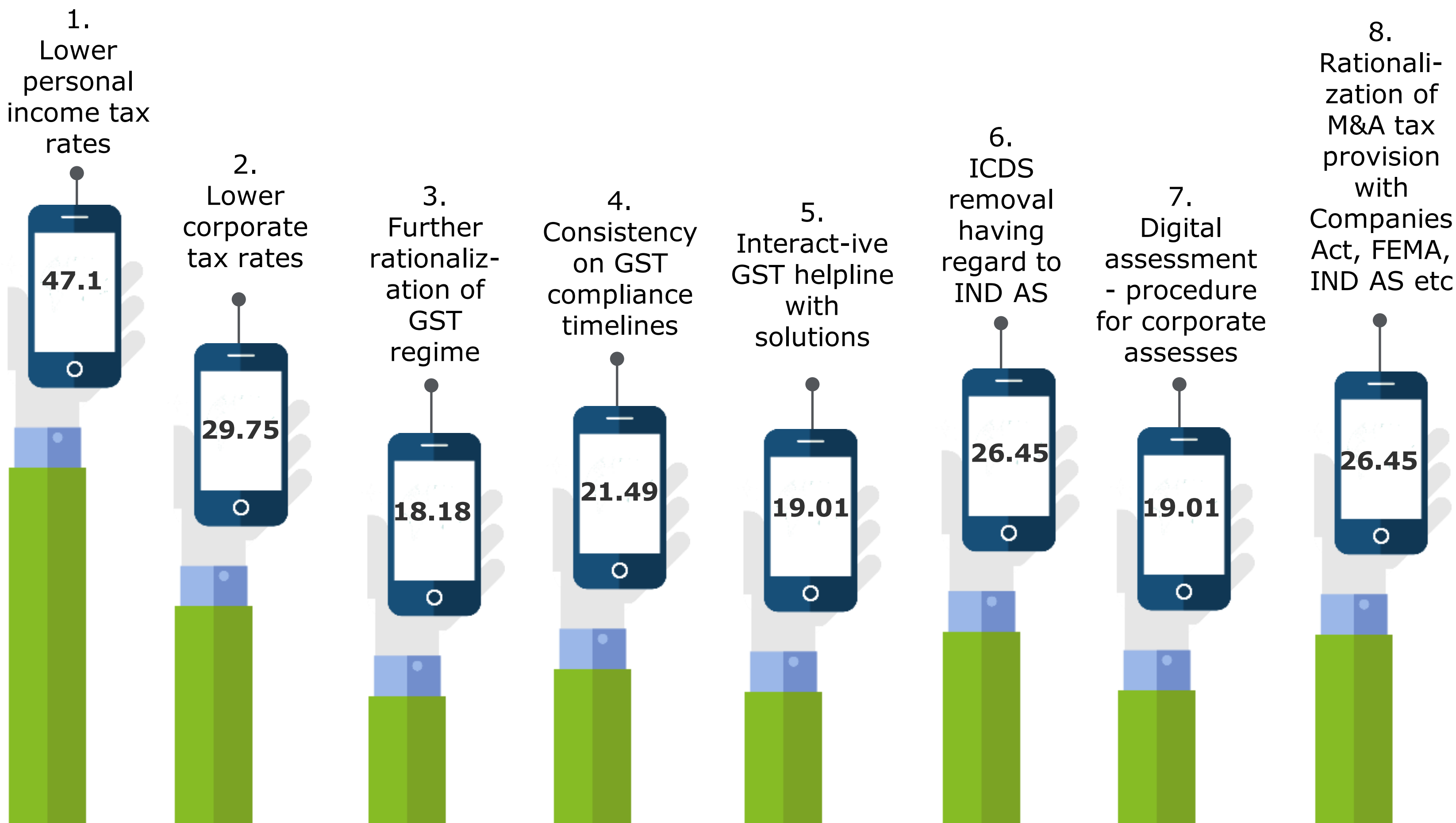
Most of the respondents (46%) believe that the MAT provisions along with provisions of Sec 56(2)(x) and 50CA should be amended followed by 43% saying a clarification should come stating that these provisions should not apply in case of an acquisition under the insolvency law.

MAT provisions have not yet been amended to extend the exclusion (for liabilities written back under IBC) to an insolvent company thus liable to pay tax @20% on book profits. Further, the acquirer under section 56(2)(x)/50CA would be liable to pay tax on the FMV of listed shares of the stressed companies.



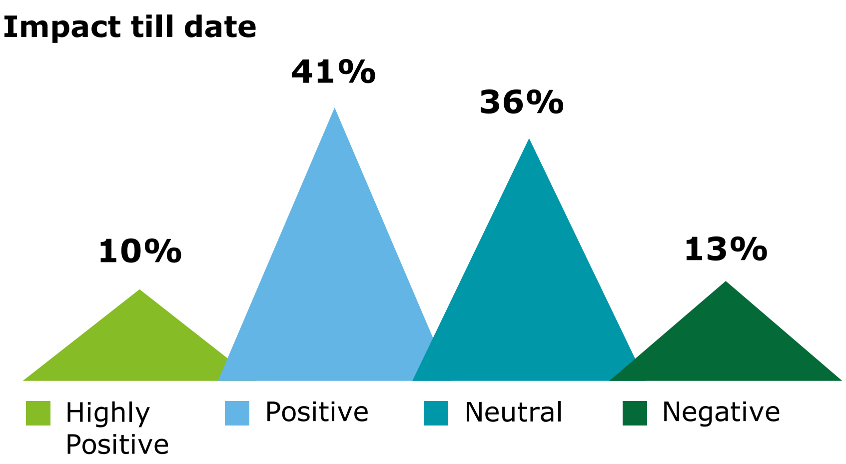
IDT

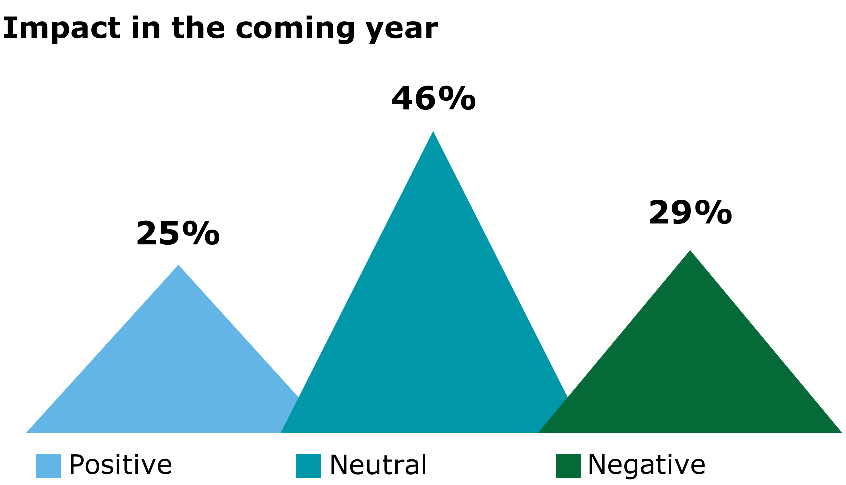
Please rank, in terms of priority, the following actions that you wish to see in the upcoming budget: (1 being top priority and 8 being least)



The GST Council has been set-up to make recommendations on tax rates, exemptions, amendment of the GST laws and other GST related changes. Upcoming Budget is expected to have minimal GST related announcements.

How would you summarize the impact of GST, on your sector/industry (Choose one)





- India’s GST structure is aligned with the OECD guidelines and based on two broad principles

  a. Final consumption or use to be taxed; and

  b. GST not to be a cost in the supply chain. While short-term impact of GST could be mixed, long-term impact is expected to be positive with reduced embedded tax costs, reduced logistics costs, additional credits etc.

- On the impact of GST, 46% of the respondents expressed that impact of GST on their respective sector/industry till date has been neutral while 25% feel that the impact has been positive. Majority (51%) expressed that, in the coming year, GST would impact their sector/industry positively, while a small percentage (13%) still feels that impact would be negative.

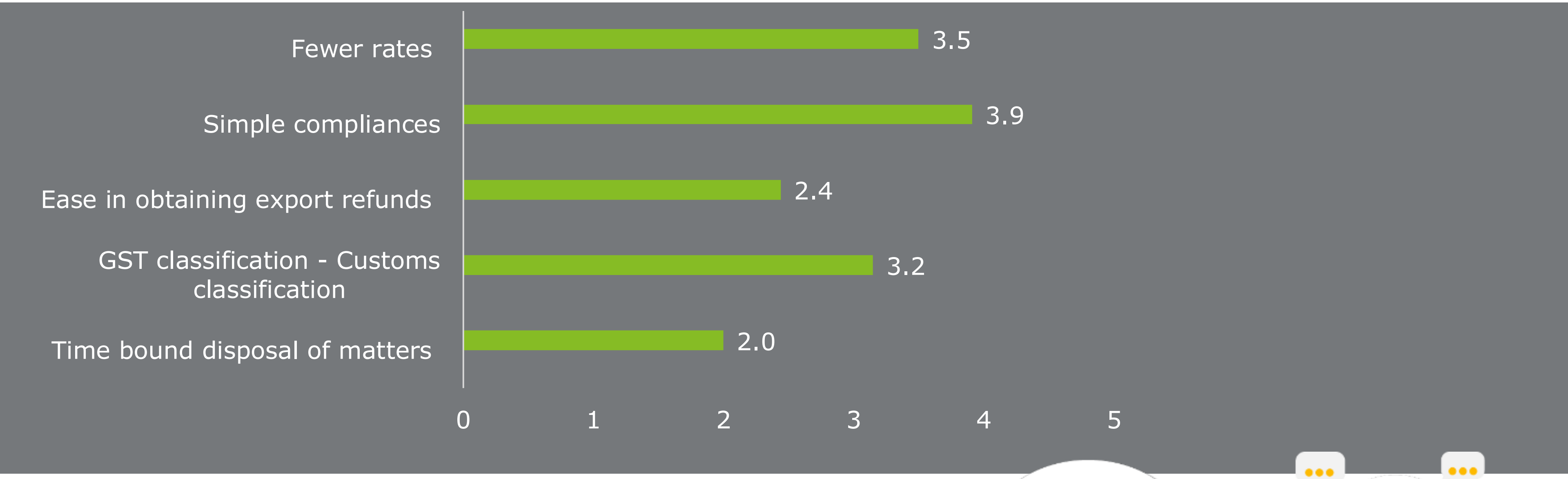
- Overall impact appears to be neutral

  GST rates on mass consumption items reduced

  – Hiked on luxury/de-merit products

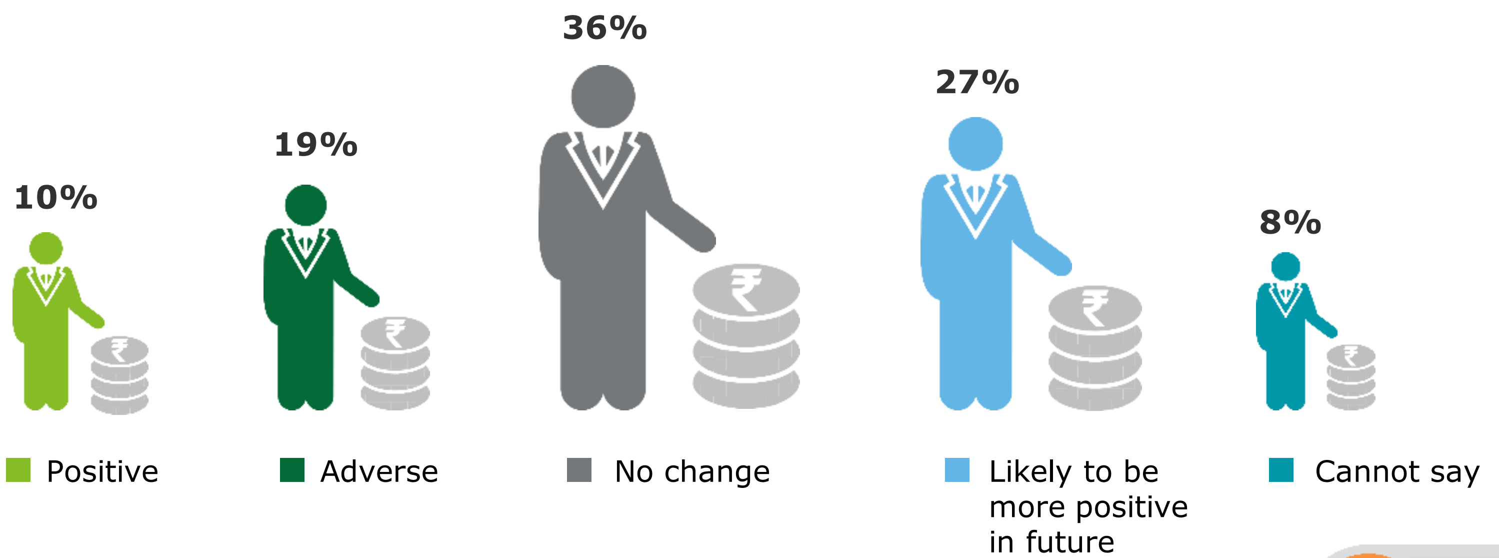
  – most of the remaining items kept on par with earlier slabs.

Please rate the following reforms, in terms of priority, that should be done in the existing GST framework: (1 being top priority and 5 being least)



Post GST implementation of GST, tax rates, legal provisions and compliance timelines have been frequently amended and revised. Filing of GST returns (GSTR-2 and GSTR-3) has been deferred and additional summary return (GSTR-3B) has been prescribed for the time being. All features of the GST portal, the backbone of GST compliances, is yet to be operational. Hence, simpler compliance has emerged as the top priority reform sought in the existing GST framework.

What is the impact of GST on your production and sales: (choose one)



Government's strategic reforms: ~~of~~ GST and 'Make in India' aim at boosting India's manufacturing sector and increasing its share in GDP. With GST implementation, production and sales likely to gain positively on account of cost reduction with additional credits, lower transportation time and cost with removal of checkpoints and permits, re-designing of supply chain etc. Majority of respondents (73%) were of the view that GST has either impacted production and sales positively or has been neutral. While others were not sure about the impact or felt the impact was adverse.

Transfer Pricing

Is the legal owner of the software/IP/intangible involved in undertaking/controlling the DEMPE functions?

As per BEPS Action plan 8-10, an enterprise which is not the legal owner of an intangible performs value-creating DEMPE functions, is entitled to earn return for its value adding activities. Thus, mere legal ownership does not entitle return on intangibles to legal owner. Main thrust of BEPS is to align the return on intangibles with the economic activities carried out by an entity. A majority of our respondents (65%) were in agreement with the fact that the legal owner may or may not be involved in undertaking the DEMPE function.

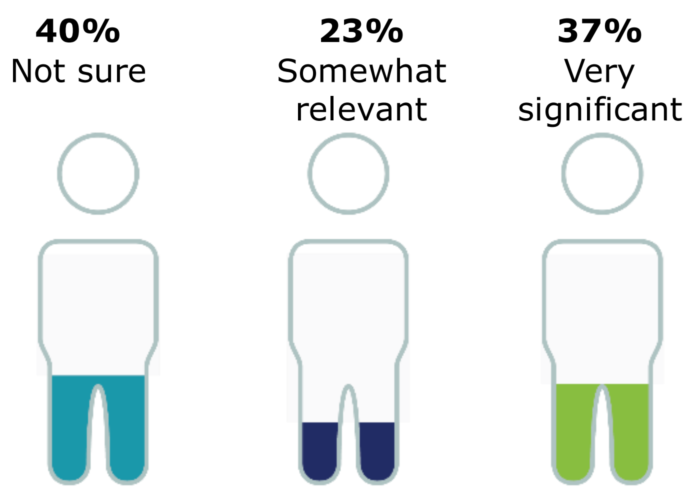
65%
Yes

9%
No

26%
Not sure

How relevant is human capital related intangible for the TMT sector, from a BEPS perspective

In today's challenging business environment, the performance of human capital plays an important role in the success of the TMT sector. As the technology continues to advance , it will make it increasingly possible to perform complex tasks and decisions . However, these complex tasks are cohesively undertaken with the support of human intervention. Thus, majority of our respondents (60%) also acknowledge that human capital related intangible is relevant for the TMT sector; while the rest (40%) are of the view that the impact was insignificant or nil.



Is the legal owner of the software/IP/intangible involved in managing the funding risk & operational risk

The revised transfer pricing guidelines set out in BEPS action plan 8-10 clarify that entities that have mere legal ownership of intangibles or a contractual allocation of risks should only be entitled to a risk-free return under the arm's length principle. One third of the respondents (33%) believe that the legal owner of intangibles do manage the funding and operational risk. As per BEPS Action 8-10, only such entities would be entitled to intangible return for undertaking the funding & operational risk of IPs. Legal ownership solely does not entitle an entity for the intangible return.

33%
Yes

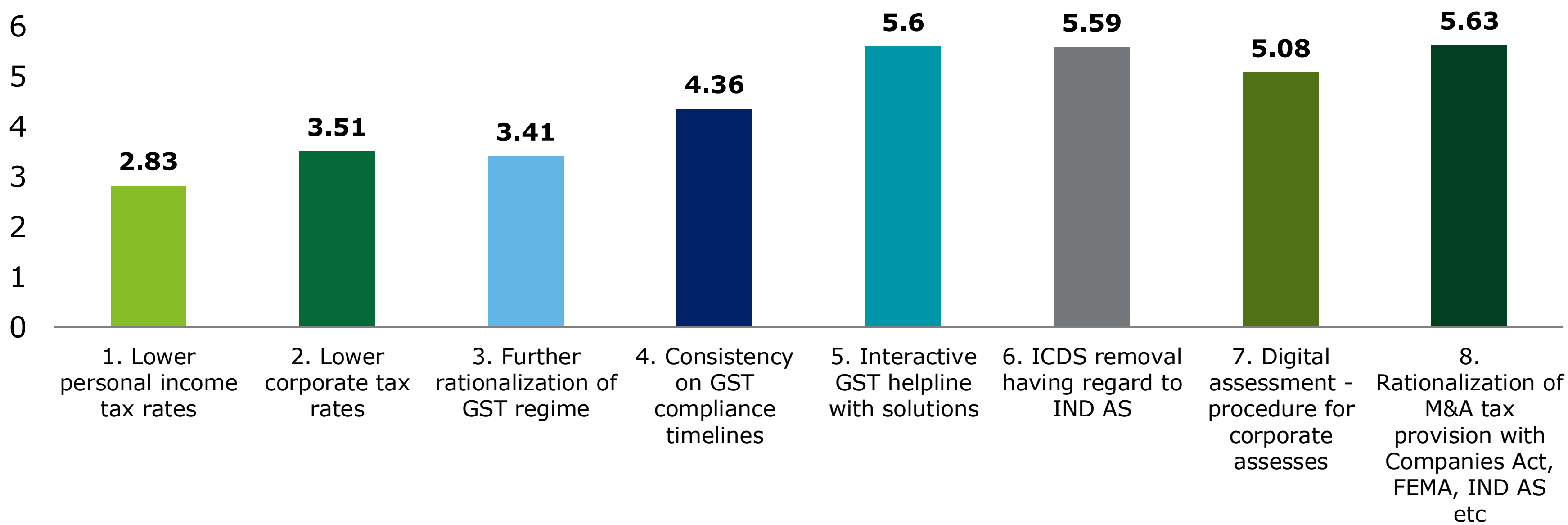
17%
No

50%
Not sure

M&A

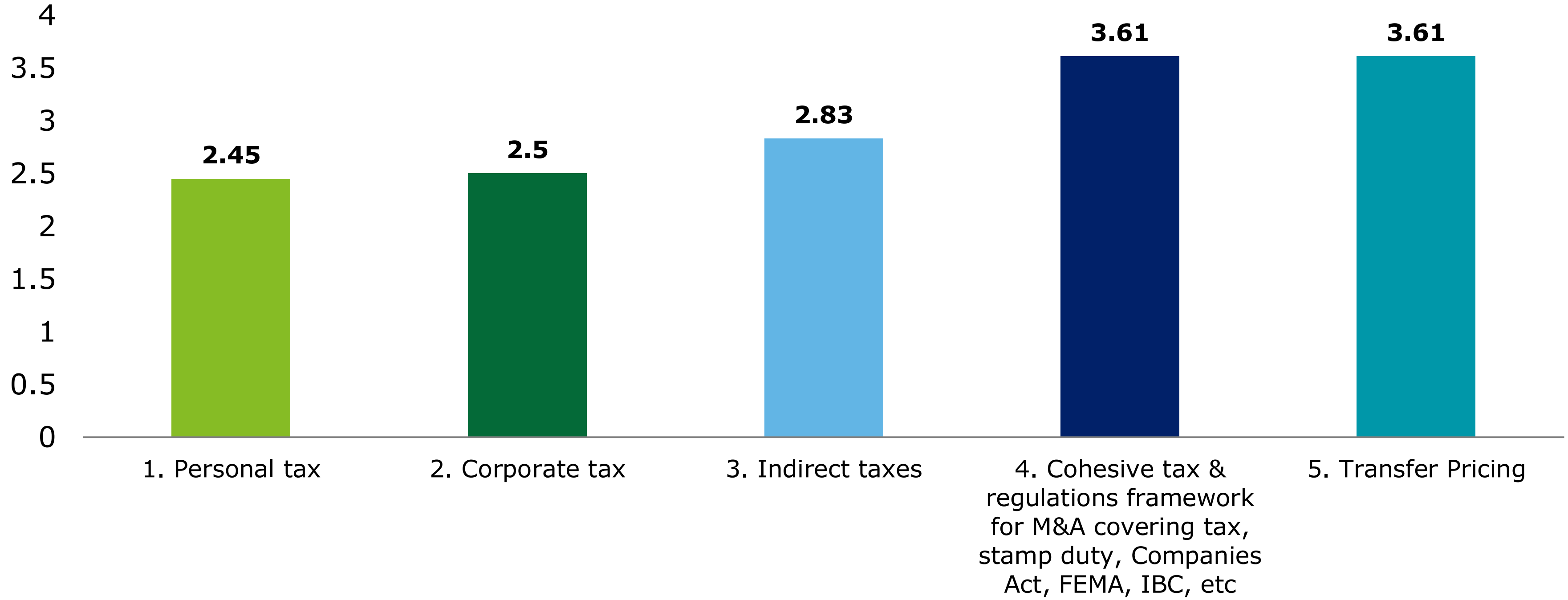
Please rank, in terms of priority, the following actions that you wish to see in the upcoming budget: (1 being top priority and 8 being least)

On the issue of rationalisation of M&A related regulations being addressed in the coming Budget, the respondents had a mixed viewpoint. Whilst they felt that the same should be undertaken, they were not sure on the same being addressed in the coming Budget.



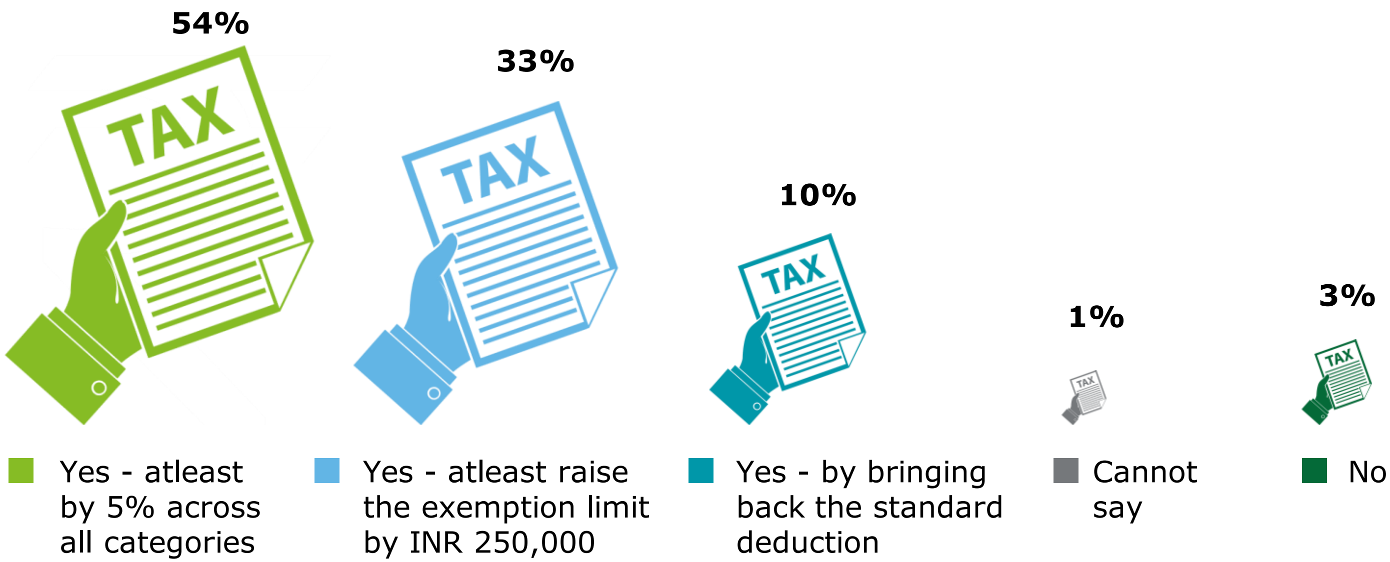
In your view, which area of the Indian tax regime is most in need of reforms/rationalization (Rate 1 to 5)

On the aspect of whether reform / rationalisation of tax provisions / regulations dealing with M&A, the respondents felt the need for reforms especially, to have a more co-joined project amongst the several regulators while forming M&A regulations. Unless the same happens, the M&A scenario would remain complex.



Personal Tax

Do you think that FM should lower personal income tax rates in the coming Budget?



Given the increase in cost of living and inflation, there is a need for reduction in tax outgo at personal level. Majority of the respondents have placed weightage on tax rate reduction by at least 5% across all categories (54%), followed by raising the exemption limit by at least INR 250,000 (33%) and by bringing back the standard deduction (10%).

These measures for reduction in taxes will make available more funds to an individual which will boost domestic demand and kick-start savings and investment.