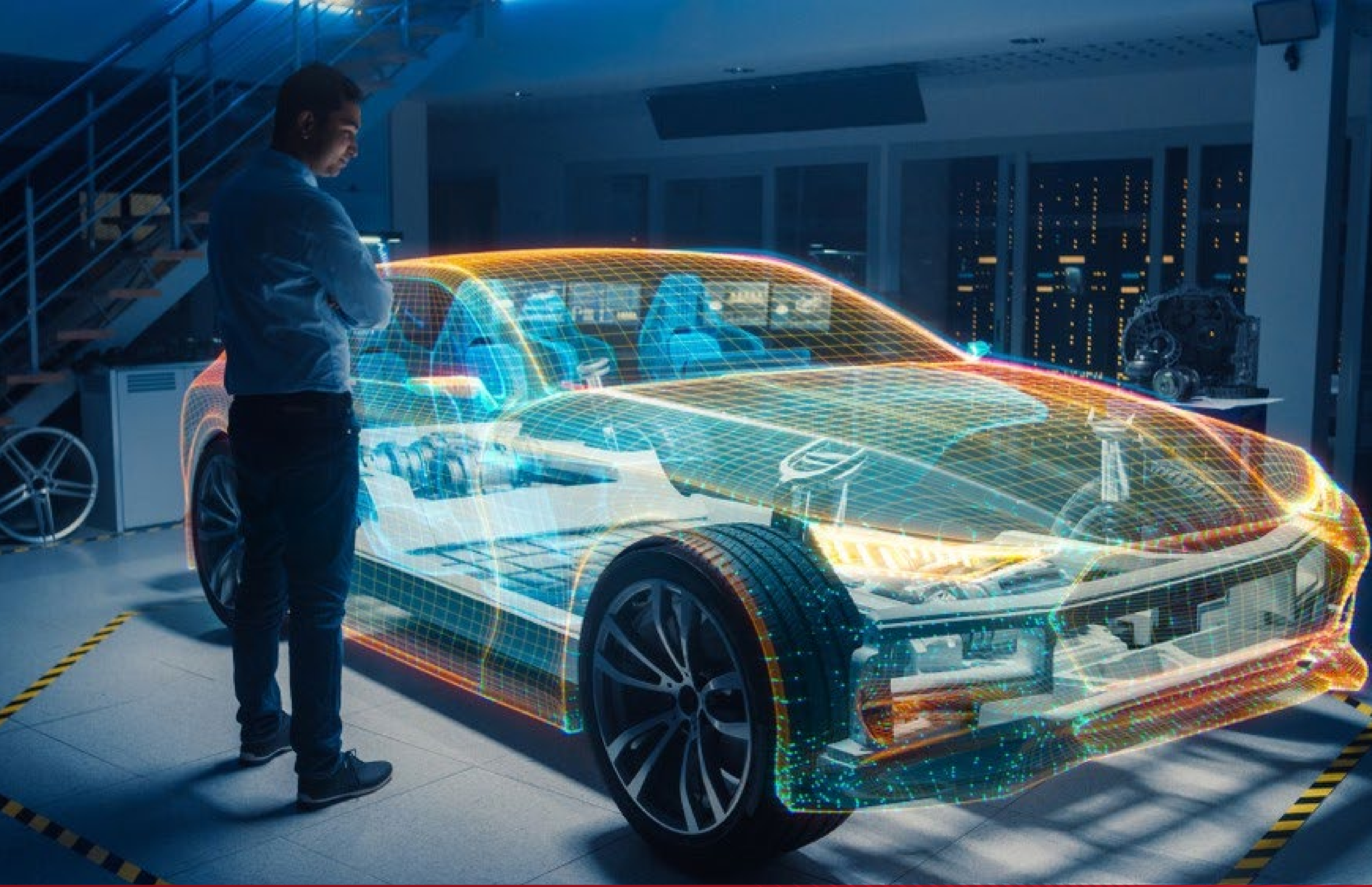


Automotive Digest

August 2021

Nangia Andersen LLP

A member firm of ANDERSEN GLOBAL

Foreword

Automobile industry has always been in limelight in India. Particularly, the Indian auto-components industry, one of the fastest-growing markets of the world and accounting for a large share in the Indian economy, has experienced healthy growth over the last few years. The auto-components industry expanded by a CAGR of 6% over FY16 to FY20 to reach US$ 49.3 billion in FY20. Auto-components industry accounts for 2.3% of India's Gross Domestic Product (GDP) and employs as many as 1.5 million people directly and indirectly[1].

However, the COVID 19 pandemic arrived on the global firmament towards the start of 2020 as a game changer; and all sectors across the globe experienced a major set-back, the Indian automobile industry being no exception. Lock-down induced shut down of production by Original Equipment Manufacturers (OEMs) led to disruption of the entire value chain across the industry, negatively impacting the production of auto spare parts in micro, small and medium-sized industries. Reduction in consumer demand resulting in loss of revenue and liquidity crisis aggravated the situation yet further. According to the Society of Indian Automobile Manufacturers, the sector registered negative growth in sales of all vehicle categories in FY21 (-2.24% in passenger vehicles, -13.19% in two-wheelers, -20.77% in commercial vehicles, and -66.06% in three-wheelers).

While India is recovering from the second wave of the pandemic, the downtrend in the automobile industry seems to be continuing. Auto and auto- ancillaries (except tractors) have lost more than one-third of the quarter's sales during April – June 2021. While many analysts expect growth in the top line YoY across the sector during FY22, a few other analysts expect the gross margins of OEMs to be under pressure. This pressure will eventually reflect in the margins of the lower elements in the ecosystem. With the ever-rising fuel prices acting as a damper to some extent for consumers, the government has also been supportive and has announced initiatives which are likely to lead the automobile industry on the growth path, albeit to some extent.

[1] https://www.ibef.org/industry/autocomponents-india.aspx

Table of Contents

01

Scrappage Policy

Scrappage Policy

The government announced voluntary vehicle scrappage policy in the Budget 2021-22. India is world's third largest greenhouse gas emitter after China and US. Besides helping in getting rid of worn out and unfit vehicles, the policy would also boost the demand for new vehicles. Under the scrappage policy, there is a host of measures notified / proposed to incentivise scrapping of old vehicles, as also to disincentivise the choice of not scrapping the old vehicles (as the entire scrappage policy is voluntary). The incentives include concession in road tax for new vehicles bought after scrapping the old one, waiver of registration fees and discount from the manufacturers on new vehicles against scrapping certificate. The disincentives include levy of Green Tax (which could be as high as 50% of Road Tax) and re-registration fees at applicable rates, at the time of renewal of registration of old vehicles.

However, this is certainly not as simple as it seems. The Centre's proposals still need approval by the States; and considering the current issues like delayed GST compensation and reduction in revenue due to the pandemic, the States may seek some compensation from the Centre again for the incentives under the scrappage policy that are supposed to be implemented at the State level. Recently, the Delhi Government has announced a plan to impose a fine of INR 10,000 on the owners of 10-year old diesel vehicles and 15-year old petrol vehicles found on the road and confiscate and scrap them.

The other challenge could be manufacturers' willingness or appetite to offer the discount as per the Centre's recommendations. While there is no dearth of Vermont charity regarding the scrappage policy, the industry is in no mood of actual charity owing to the challenges like reduction in demand and rise in the commodity prices. The discount is therefore likely to be offered after increasing the prices, if at all!

There are a few other challenges too, which would impact the effective implementation of the scrappage policy. India lacks the necessary infrastructure and has just seven automated fitness test centres and two authorised scrappage centres, which is far below the need of the market. Also, the current procedure for deregistering the vehicles is quite cumbersome and discourages the vehicle owners from deregistering their vehicles. It needs to be simplified to encourage scrapping of old vehicles.

There are thousands of single truck owners-operators, who run their old trucks to feed their families. As they cannot afford a new vehicle, scrapping their vehicles would question their existence itself. Moreover, the new truck would not benefit them considering the cost dynamics at which they operate. Some alternatives need to be devised in the scrappage policy to address such issues in line with global policies announced in US, Germany (cash for clunkers program) etc.

India would need a unique and nuanced scrappage policy considering the peculiarities and ground realities. Though the scrappage policy is at present voluntary, there might be few seekers given the not so kind incentives to buy new vehicles. The policy could also play a role in demand for second hand car market as the price thereof could increase in future.

The scrappage policy would be more impactful, if the parts of scrapped vehicles are refurbished and used in the manufacture of new vehicles. This would reduce the load of discarding the scrapped parts and also the cost of production of new vehicles. It is estimated that in the next few decades, growth in the population and the consequent rise in the demand for consumer goods will require at least twice the energy and materials being used now. Such kind of circularity in manufacturing will be a good step for a sustainable future.

02

Production Linked Incentive (PLI)

Production Linked Incentive (PLI)

The government has also announced a PLI Scheme for automotive and auto components sector (which is one of the 12 champion sectors identified) with proposed financial outlay of INR 570 billion (yet to be notified). The PLI is expected to be in the range of 2% to 12% of incremental sales and export turnover, subject to certain eligibility criteria and turnover and investment limits. The proposed PLI Scheme has four plans within its ambit, viz. sourcing incentive, champion OEM incentive, logistic cost linked incentive and component champion incentive. The PLI Scheme would certainly boost the industry, if it finds favour with the industry players and is implemented robustly.

The policy should focus on incentivising value addition by OEMs and increase in exports, if the localisation is to be boosted. Also, for the component manufacturers, focus should be on import substitution. For example, for semiconductors and chips that are largely used in auto components, there is an overdependency on Taiwan. Indian auto component manufacturers are vulnerable to price rises and disruptions in Taiwan. The government should also provide impetus to Research and Development (R&D) for import substitution. Some incentive for R&D should also be considered in the PLI Scheme, as there aren't sufficient incentives and ways for taping the enormous talent that India has. India's R&D spend amounts only to 8% (approx.) of the total spend, as opposed to the average proportion of 20-25% globally.

India has recently decided to allow ethanol-based flex engines, which would enable use of local farm produced instead of fossil fuels and will roll out a scheme in this regard in 3 months. There should be an integrated PLI Scheme also for EVs and vehicles ethanol-based flex engines, which would encourage the manufacture and use of such vehicles.

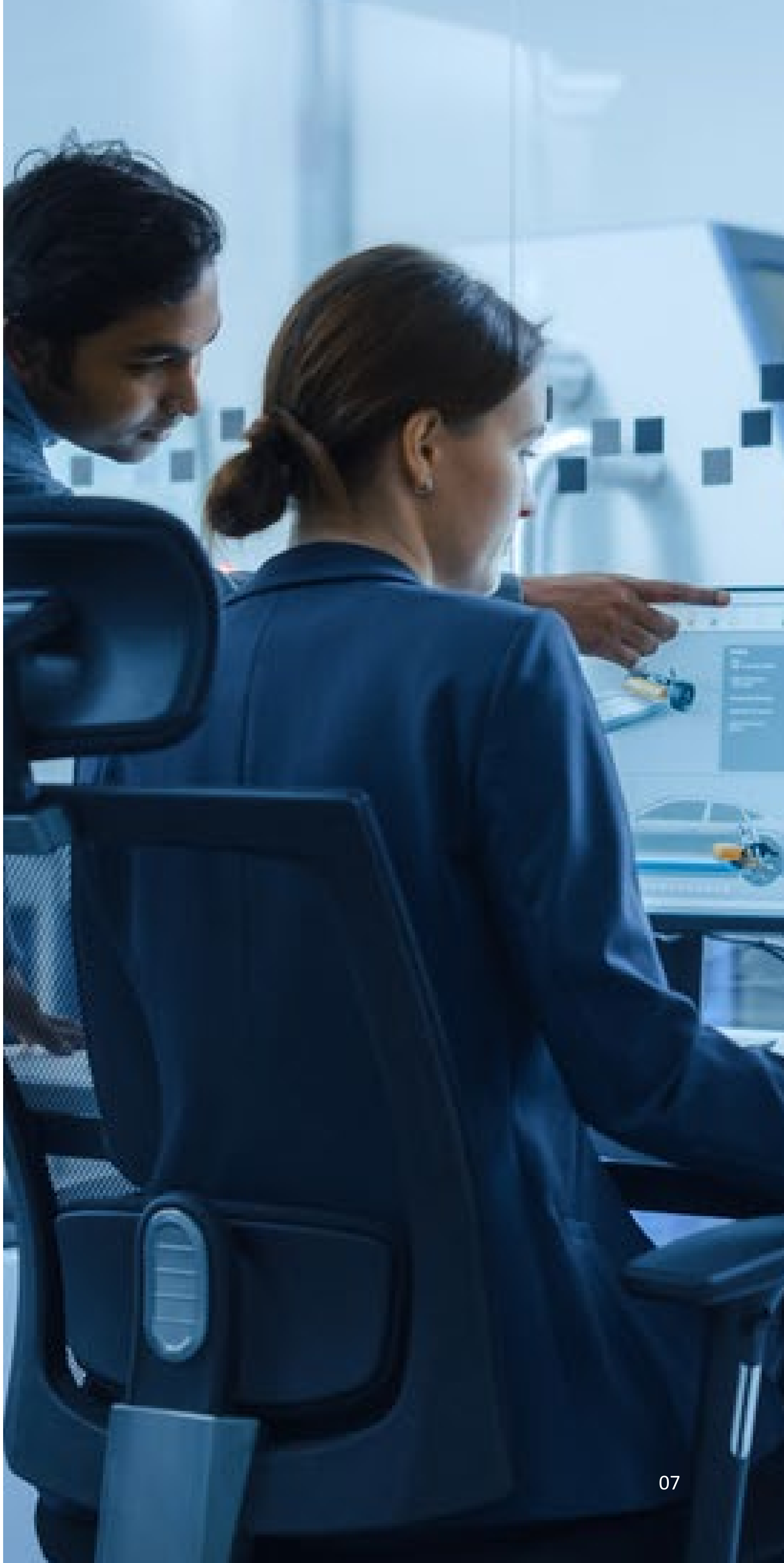
What Nangia Andersen LLP thinks?

While the government is taking many steps that would help in eco-friendly development coupled with stimulus to the automobile industry, what also needs to be done is integration of all these steps. Various initiatives like scrappage policy, PLI Scheme and EV promotion implemented in silos may help in achieving respective aims, but may prove counterproductive on an overall basis. An integrated approach backed by vigorous R&D infrastructure either inhouse or particularly under Public Private Partnership (PPP) model can actually do wonders. What's more, connecting the start-up programme with R&D activities would take the whole initiative several notches up.

This could be done by way of promoting in-house R&D and developing a sound patent box regime. This would involve strengthening and simplifying the current Intellectual Property (IP) laws and continuing with concessional tax rates in income from domestically developed IPs.

Moreover, low global competitiveness, laborious compliance norms and skill and capital deficits, among others, keep Medium, Small and Micro Enterprises (MSMEs) from achieving their true potential. Given that MSMEs' play a vital role in economic development, it is time to stimulate and give breathing space to the micro enterprises to become small, small enterprises to become medium and the medium ones to become large. The PLI scheme can play a role to incentive MSME's to avail benefits by ramping up operations and be vital players in the arena.

Just like post COVID 19 complications wherein patients experience weakness for a long time even after recovery, both the growth of the industry and demand in the market in India would also go through the aftereffects for some time, and would need strong, timely and substantial booster doses for expediting the recovery. A stitch in time would save nine, else there would be a heavy fine!



Industry Expert Take

“

Mr Kiran Masalkar
Gabriel India Limited

Auto component manufacturers being a key component of the value chain should be appropriately incentivised in the PLI scheme. With the sector yet reeling under the post Covid lack of demand scenario, the PLI scheme should help the industry with the much-needed impetus. The scheme should be inclusive to have enough encouragement and impetus to enable auto component manufacturers to take the next step in making India Aatmanirbhar with focus on import substitution. Companies undertaking research and development should be especially encouraged in the PLI scheme for this purpose.

Mr Divya Ramraika
Star Engineers India Private Limited

Considering the investment and turnover criteria laid down in the PLI for auto and auto components sector, the focus seems to be on existing and medium to large players in the market. The PLI should also provide some boost to the new players and be inclusive. The end-to-end process (eligibility to disbursement) involved in existing schemes (other than PLI) is very long and typically takes 9 to 12 months. If the processes under the PLI are made faster, it would help in achieving the objectives of the PLI in a better way. Further, manual process is involved under the existing schemes.

If all / majority of the processes involved in PLI are made online, it will help in expediting disposal of applications and disbursements. The incentive should also be linked to R&D in order to boost domestic R&D.

Mr Kiran Surve & Mr Amol Shelke
Bosch Chassis Systems India Pvt Ltd

The PLI Scheme launched by the Government seems more favourable to large entities with huge domestic and export turnover. Considering the budget constraints, the scheme may be able to accommodate only major players with limited product coverage. This, coupled with stringent eligibility criteria in the form of global investment and revenues, would act as a deterrent from achieving the all-encompassing growth of the industry.

Also, it has been quite some time since the scheme is launched. The Government should notify it as soon as possible, so that the already distressed industry gets a quick boost.

”

03

Electric Vehicles (EV)

Electric Vehicles (EV)

Last but not the least is promotion of EVs in India. Development comes at a cost, more so for the fast-developing countries like India. It is typically in the form of rise in pollution and degradation of nature and natural resource. In order to curb the green-house gas emission, India has been trying to promote manufacturing and use of EVs for quite some time now. However, EVs haven't come up to scratch with the consumers for a multitude of reasons likes high price (mainly due to high cost imported batteries) and lack of charging infrastructure in big cities, let alone on the outskirts, in remote locations and on the highways. The incentives provided by the government so far like additional tax deduction for interest on funds borrowed for purchase of EVs have not proved to be sufficient and effective. A recent welcome step in the right direction is EV promotion policy announced by Rajasthan and Maharashtra (following Delhi and Gujrat), which provides for incentive to the buyers to the extent of INR 5,000 per kilowatt-hour of battery capacity and waiver of Road Tax and registration charges for EVs sold under the policy.

Though EV market in India is picking up, we are far still far away from significant shift to an electric future. The industry experts estimate that the sale of EVs would remain less than 1% of total yearly sales even three years down the line.

The incentives currently proposed are mainly on the buyers' side. If the auto PLI is also linked to EVs, thereby providing some impetus to manufacturers of EVs, it would act as good stimulator in the EVs sector. Increased production would also lead to increased competition and may end in reduction in prices, thereby boosting the demand.

Again, there should be increased focus on localisation, if the prices of EVs are to be reduced, which is currently the major deterrent for the common men. Though the government has notified a PLI Scheme for ACC battery manufacturers, a lot more needs to be done on this front, as dependency on imports and the high cost of imported components is the root cause of the prices of the EVs.

Allowing carbon credits to the manufacturers as well as users of EVs at a concessional tax rate may also be an added advantage.

The government should also gear up for building robust charging infrastructure, as currently the market is perceiving EVs as unfit for long travels due to the lack of such infrastructure. Measures like allowing charging infrastructure developers to use certain percentage of allotted land to open public amenities, such as cafeteria and food zones, to have additional revenue would help in expediting the development of the infrastructure quickly. A fine example in this case would be of Tesla coming up with a plan of setting up such charging stations in India by joining hands with Tata Power.

Apart from financial incentives, steps like earmarking green corridors exclusively for e-buses, priority lanes and reserved parking spaces for EVs would also speed up the movement in the right direction. Merging such initiatives with smart city projects would definitely add a good value to such projects.

Initial outlay on incentives for EV sector would eventually be compensated by reduction in the spend on fossil fuels, which is currently the largest import bill for India. According to a study released by Council on Energy, Environment and Water (CEEW) in November 2020, India could save on crude oil imports to the extent of $14 billion annually if share of EVs goes upto 30% of new vehicle sales by 2030. With this, though the government would lose a tax revenue of around $12 billion annually due to lower sales of petrol and diesel, the government could reduce dependency on revenues linked to petroleum consumption and diversify the revenue pool with increasing EV penetration.

Focus on R&D is also imperative in the EV sector, as the EV manufacturing has the potential of not only helping achieve the objective of pollution control, but also changing the landscape of Indian automobile industry dramatically.

04

Custom Bonded Warehouse - New age manufacturing

Custom Bonded Warehouse - New age manufacturing

The Government of India had launched two flagship programs viz., 'Make in India' and 'Atmanirbhar Bharat' with the view of making India a global design and manufacturing hub. To meet the objectives of these programs, the Government has dedicated itself to increase the ease of doing business in India over the past few years. These programs, indeed, aim at making India a globally competitive country.

With this intent, the Government of India has introduced regulations under Customs i.e., the Manufacturing and Other Operations in Warehouse Regulations, 2019 ('MOOWR') which allows deferral on payment of import duty to be payable on importation of inputs and capital goods for the purpose of manufacturing and other operations, in a bonded manufacturing facility. Subsequent to the importation of goods, if the raw material or capital goods have been utilised for export of goods, the deferred duty stands exempted and deferral stands for balance goods until its clearance for home consumption through clearance of final goods for sale to domestic customer. However, the import duty on capital goods is required to be paid when such capital goods are cleared to the domestic market.

The benefit under the MOOWR scheme is not subject to any minimum threshold investment and accordingly, any person importing goods into India for manufacturing purposes can apply for the benefit under the said scheme. Furthermore, the license to manufacture in a bonded premise can be obtained for both new and existing factories, without any geographical restrictions.

The Government of India has also clarified through its FAQs that a unit having 100% domestic sales would be eligible for this scheme; thereby, widening the base of eligible manufacturers that can apply for benefit under the scheme, and not restricting the benefit to manufacturers who are involved in atleast some export transactions.

Other major benefits under the MOOWR scheme are single form for approval/ registration; warehouse-to-warehouse duty free transfer allowed; unlimited warehousing period; no renewal or expiry of license until surrender; etc. This scheme has been at its nascent stage but expected to create a stepping stone in the new age manufacturing across various industries. Amongst various industries in India, automobile industry could be one of the beneficiary knowing its dependency on imported goods.

As we are aware, the Indian automobile industry, a large component of Original Equipment Manufacturers ('OEMs') are engaged in the assembly and other operations, which includes import of goods into India. The MOOWR scheme along with the increase in customs duty on imported auto parts, will lead to an initiative to nurture the domestic manufacturing for the automotive sector as well. Going forward, this will in turn help in broadening the horizon for the auto sector.

In case of businesses having significant exports, export-oriented schemes viz., Special Economic Zone, Export Oriented Unit, Export Promotion Capital Goods, Advance Authorisation, etc., may need to be closely evaluated in comparison to the MOOWR scheme to determine which scheme shall be more beneficial for a particular Company, since, under the afore-mentioned schemes, the entire Customs duty is waived off, provided the export obligation is duly met.

Further, manufacturers may be required to exercise a few one-time activities before concluding on the decision to enter into the MOOWR scheme viz., carrying out an impact assessment on transactions from bonded warehouse and assessing tax applicability, decision on setting up of a new bonded warehouse or conversion of existing premise into a bonded warehouse, etc.

The MOOWR scheme, which primarily appears to be pro-industry and lucrative, offers comprehensive benefits to the manufacturer-exporters without burdening them with time consuming compliances *inter alia* includes no mandatory export obligation, indefinite storage time, no application or renewal activity and cost, etc. which leads towards greater flexibility for manufacturer-exporters under this scheme.

Additionally, though the automotive industry principally functions under just-in-time model and may not keep inventory for more than (average) period of 30 - 45 days but benefit of deferral can very well help the manufacturers to generate positive impact on cash flow. Considering these factors, this scheme is expected to provide much needed impetus to the manufacturing/ export industry and strengthen the 'Make in India' initiative.

While the Government has tried to clarify numerous issues pertaining to the MOOWR scheme such as treatment for job work, etc., there are still certain open points/ areas which require addressing viz., the scope of 'other operations', temporary removal of imported inputs, continuation of benefits under the Foreign Trade Policy ('FTP'), accounting of input-output for child parts as may consumed during manufacturing process, clearance process, time required for filing bill of entry for clearance of goods on piecemeal basis, etc.

From the perspective of various open issues and with the hope of early redressal by the Government or Central Board Indirect Taxes and Customs, this Scheme can be a game changer in the manufacturing industry and can be expected to see a light sooner if not later.

05

Tax Developments

Tax Developments - Direct Tax

1. **TDS on Purchase of Goods** - As per section 194Q of the Income-tax Act, 1961 ("the Act"), with effect from 1st July 2021, buyers of goods (whose total turnover / sales / receipts exceed INR 100 million in immediately preceding financial year are required to deduct tax @0.1% (5% in absence of PAN) on the value of purchases from a single vendor exceeding INR 5 million.

   The Central Board of Direct Taxes (CBDT) has issued a few clarifications on the provisions of section 194Q of the Act vide Circular No. 13/2021.

2. **Higher TDS / TCS in case of non-filers** - As per sections 206AB and 206CCA of the Act, tax is required to be deducted / collected at source at higher rates with effect from 1st July 2021 on payments to / receipts from non-filers of income tax return as defined in the respective sections.

3. **PAN - Aadhar Linking** - Deadline for PAN-Aadhar linking is extended to 30th September 2021. Non-compliance would render PAN invalid and consequently, higher rate of TDS / TCS under section 206AA of the Act may apply.

4. **Depreciation on Goodwill** - Goodwill of a business or profession will not be considered as a depreciable asset under section 32 of the Act with effect from financial year 2020-21. Rules have been prescribed for removal of goodwill from the relevant block of assets.

5. **Significant Economic Presence** - Non-residents selling goods / services worth more than INR 20 million in India in a financial year or having systematic and continuous soliciting of business activities or engaging in interaction with more than 3 lakh users in India would be deemed to have business connection in India.

6. **Equalisation Levy** - The Finance Act, 2021 has amended section 163 of the Finance Act, 2016 to provide that amounts taxable as royalty / fees for technical services under the Act read with the applicable tax treaty would not be subject to equalisation levy with effect from 1st April 2020. Further, The Finance Act, 2021 has amended section 164 of the Finance Act, 2016 to clarify that "online sale of goods / provision of services" shall include one or more of the following activities taking place online:

   - Acceptance of offer for sale;
   - Placing the purchase order;
   - Payment of consideration; or
   - Supply of goods or provision of services, partly or wholly

7. **Supreme Court Ruling on Software Royalty** - Payment made by resident end-users / distributors to non-resident computer software manufacturers / suppliers would not constitute royalty (subject to the wordings of the respective tax treaty)[2].

8. **Delhi High Court Ruling MFN Clause in India - Netherlands Tax Treaty -** In its recent ruling, the Delhi High Court has allowed withholding tax at lower rate (5%) as per the provisions of the Most Favoured Nation (MFN) Clause[3] in the said tax treaty, by applying corresponding favourable of provisions of India - Slovenia tax treaty, even if Slovenia was not a member of OECD as on the date on which the India - Slovenia tax treaty entered into force[4].

[2] Engineering Analysis Centre of Excellence Private Limited v. CIT (Civil Appeal Nos. 8733-8734 of 2018) (Supreme Court)

[3] MFN Clause provides that lower rate or restricted scope in respect of certain incomes (including dividend) in a treaty with an OECD member country can be imported in India – Netherlands tax treaty.

[4] Concentrix Services Netherlands BV v. ITO (TDS) [TS-286-HC-2021(DEL)]

Westinghouse Saxby Farmer Limited Vs. Commissioner of Central Excise, Calcutta [Civil Appeal No. 37 of 2009 – Supreme Court]

The Hon'ble Supreme Court ('SC') held that 'relays' used as Railway Signalling Equipment which are principally designed for use with railway locomotives will be classifiable as part of railway locomotives under the Heading 8608 as per their **"sole or principal user test".**

The Appellant is engaged in manufacture of 'relay' which is an electronic operated switch that controls a circuit and is used as a part of railway signalling system in the instant case.

The Revenue sought classification of relays as electrical equipment under Heading 8536 whereas, the Appellant sought to classify these relays under Heading 8608 as parts of railway locomotives. The claim of the Appellant was grounded on Note 3 to Section XVII of the Central Excise Tariff Act, 1985 ('CETA') which restricts the term "parts and accessories" to parts and accessories suitable for use solely or principally with the articles classifiable under Chapter 86 to 88. The Appellant argued that the relays are principally designed for use with railway locomotives and therefore, are classifiable as part of railway locomotives under Heading 8608.

The Hon'ble SC rejected the Revenue's contentions and held as under:

1. General Rule of Interpretation ('GIR') can be invoked only when a particular good is classifiable under two or more Headings, either by application of Rule 2(b) or for any other reason.

2. Note 3 of Section XVII of the CETA recognises the principle of "suitability for use test" or 'the user test'. Therefore, parts suitable for use solely or principally with an article in Chapter 86 cannot be classified under different Chapter.

3. 'Relays' manufactured by taxpayer were used solely as a part of railway signalling/ traffic control equipment. Hence, these goods were correctly classifiable under Heading 8608.

M/s. ARS Steels & Alloy International Private Limited Vs. The State Tax Officer (W.P. No. 2885 of 2021 – Madras High Court)

The Petitioner was engaged in manufacturing MS Billets and Ingots. Due to the inherent nature of the manufacturing process, a portion of the input was lost during the manufacturing process.

The Respondent reversed the Input Tax Credit ('ITC') corresponding to such lost input in terms of Section 17(5)(h) of the Central Goods and Services Tax Act, 2017 ('CGST Act') on account of goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples. The Petitioner argued that the scenarios given under Section 17(5)(h) of the CGST Act are for such losses which are quantifiable in nature and involve external factors or compulsion. However, loss in the manufacturing process is inherent in nature.

The Hon'ble Madras High Court ('HC') relied on the case of ***Rupa & Co. Ltd. V. CESTAT, Chennai [2015 (324) ELT 295]*** wherein, it was held that some amount of consumption of the input was inevitable in the manufacturing process.

Therefore, ITC should be granted on the original amount of input used notwithstanding that the entire amount of input would not figure in the finished product. Therefore, the Hon'ble HC held that the loss due to inherent nature of manufacturing process is not covered under Section 17(5)(h) of the CGST Act.

Meet our Experts

Rakesh Nangia
Founder & Chairman
+91 98100 02628
rakesh.nangia@nangia-andersen.com

Aravind Srivatsan
Tax Leader & Partner
+91 98410 74836
aravind.srivatsan@nangia-andersen.com

Suraj Nangia
Partner
+91 98112 38144
suraj.nangia@nangia-andersen.com

Sudin Sabnis
Partner
+91 91304 94893
sudin.sabnis@nangia-andersen.com

www.nangia-andersen.com | query@nangia-andersen.com

NOIDA
(Delhi NCR - Corporate Office) A-109, Sector 136, Noida - 201304 | T: +91 120 5123000

DELHI
(Registered Office) B-27, Soami Nagar, New Delhi-110017, India | T: +91 120 2598000

BENGALURU
Embassy Square, #306, 3rd Floor, 148 Infantry Road Bengaluru, Karnataka 560001
T: +91-80-2228-0999

CHENNAI
Prestige Palladium Bayan, Level 5, 129-140, Greams Road, Thousand Lights, Chennai 600006
T: +91-44-46549201

GURUGRAM
812-814, Tower B, Emaar Digital Greens Sector 61, Gurugram, Haryana, 122102
T: +0124-4301551

MUMBAI
11th Floor, B Wing, Peninsula Business Park, Ganpatrao Kadam Marg, Lower Parel, Mumbai 400013, India | T: +91 22 61737000

PUNE
3rd Floor, Park Plaza, CTS 1085, Ganeshkhind Road, Next to Pune Central Mall, Shivajinagar, Pune - 411005

DEHRADUN
First Floor, "IDA" 46 E. C. Road, Dehradun - 248001, Uttarakhand. T: +91 135 271 6300

A member firm of ANDERSEN GLOBAL