

American Chamber of Commerce in India

Key Recommendations- Aerospace & Defence sector

Direct taxes

1. Exemption under section 10(6C)

Issue

- The Indian Income Tax Act provides for a specific exemption under section 10(6C) whereby royalty/ fee for technical services (FTS) income arising to a foreign company in pursuance to a defence contract shall not be taxable in India. However, there are many practical challenges in seeking the subject exemption on account of the following:
 - Quantification of royalty/ FTS amount in a lump-sum contract
 - Applicability to contracts with Defence Public Sector Undertaking, (“DPSUs”) etc; and
 - Applicability to Tier 1 or 2 players.

Recommendation

- It is recommended that the Government should permit contractual flexibility to have a segregated scope and fee for royalty and FTS portions. This shall facilitate the Central Board of Direct Taxes in quantifying the royalty/ FTS income under a particular contract.
- It is also recommended that Government specifically clarify that the exemption is also applicable on contracts with Defence Public Sector Undertakings (“DPSUs”). The Industry welcomes the recent exemption accorded by the government to M/s Rosoboronexport, Russia under a contract with Hindustan Aeronautics Limited and would request if the same could be specifically included.
- The aforesaid recommendations have been categorically specified in the recent Report by the Expert Committee formed under the aegis of Shri Dharendra Singh, to facilitate ‘Make in India’ in the Defence Sector (Expert Committee Report) and should be considered by the Government in totality to eliminate tax uncertainty.
- The Government may also consider to clarify if the 10(6C) benefit can be extended to the Tier 2/3 suppliers, as such companies are an integral part of the supplies and play an equally essential role as the OEM. Tier 2/3 companies are in most cases the real owners of the IPR against which such royalty/FTS considerations arise. Hence, the tax exemption benefit should be extended even to Tier 2/3 vendors as well.

2. Tax Incentives – Section 80IA

Issue

- Today, the Indian Aerospace and Defence (A&D) Sector has immense untapped potential and requires a huge amount of investment coupled with creation of robust facilities for in-house defence manufacturing. The “Make in India” campaign has in its forefront the development of A&D manufacturing capability in India.

The A&D sector is akin to various infrastructure sectors (ie Power, Infrastructure, Telecom,

Shipping and Fertilisers) which require huge investments at the beginning starting from research to setting up capital intensive manufacturing capabilities. Currently no specific exemption exists for this sector, specifically in the context of performance or operation based tax incentives.

Recommendation

- It is recommended that the Government should amend the existing provisions of Section 80-IA to specifically include the A&D sector, whereby manufacturers could be granted a deduction of an amount equal to 100% of the profits from operations for a stipulated period of time.
- This would encourage in-house A&D manufacturing and incentivize foreign OEMs to venture into manufacturing in India.
- Further, owing to the long gestation period of defence contracts, the performance based incentive could be granted for a longer period of about 15 to 20 years to augment defence manufacturing.

Indirect taxes

Recommendations

- Import duty should be exempted on all spare parts irrespective of usage on any aircraft.
- Aviation Turbine Fuel (ATF) should be notified as a 'declared goods' under the Central Sales Tax (CST) regime.
- Service Tax on MRO, ground handling and similar associated services should be zero rated.
- Service Tax on construction of airports should be zero rated.
