

Budget

2020

2021

2022

2023

2024

Government continues to encourage innovations to achieve self-reliance in Defence Sector



**Partner & National Leader
Aerospace & Defence
EY - India**

The Union Budget was presented by the Finance Minister (FM) on 01 February 2023. With ~6.7% in capital outlay for defence expenditure, the government has continued its effort towards defence modernization.

Increase of ~15.9% in revenue expenditure over 2022-23 (BE) indicates large portion of expenditure earmarked towards stores & spares, repairs and other services.

The Government has indicated a clear focus on infrastructure development in strategic and critical areas of the country with allocation of INR 5,000 crores for 'Works under Border Roads Development Board'.

Announcement of the 'Agnipath Scheme' has been followed up with an outlay of ~INR 4,266 crores in this budget and set-up of 'Agniveer Corpus Fund'.

Continued emphasis on innovations and technology development is evident with increased allocations of grant for creation of capital assets and grant-in-aid for schemes such as iDEX.

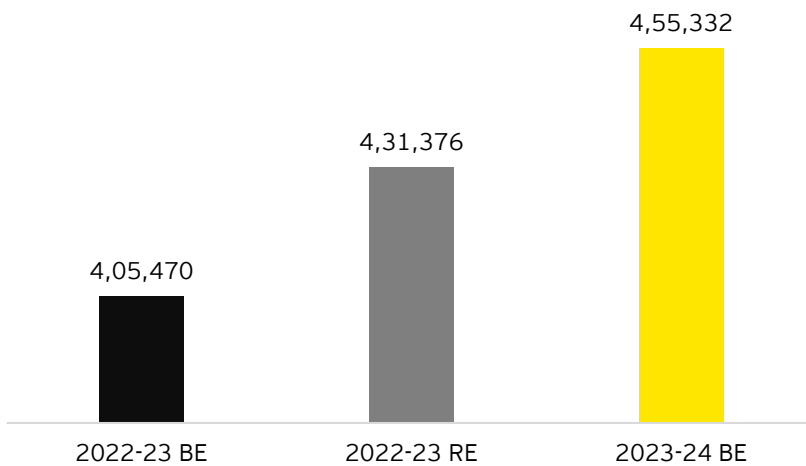
How does the budget impact defence sector?

▶ Defence allocation is accounted for under four demands for grants:

- ▶ Demand No 19 – Ministry of Defence (Civil)
- ▶ Demand No 20 – Defence Services (Revenue)
- ▶ Demand No 21 – Capital outlay on defence services
- ▶ Demand No 22 – Defence Pensions

The total defence budget (excluding defence pensions) for FY 2023-24 amounts to USD 55.65 billion (INR 4,55,333 crores). Budgetary allocation towards capital and revenue expenditure stands at USD 19.87 billion (INR 1,62,600 crores) and USD 33.01 billion (INR 2,70,120 crores), respectively.

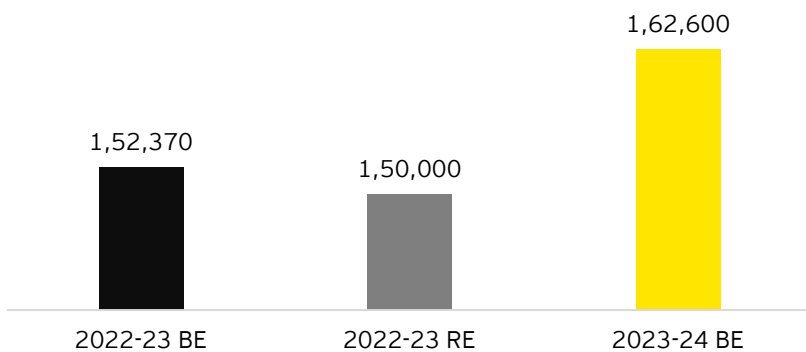
Total defence expenditure (excluding defence pensions) (INR crores)



Brief on Capital Expenditure

- ▶ Modernisation of military forces is primarily driven by the capital outlay within each year's budget. Budgetary allocation towards capital expenditure for this year is USD 19.87 billion (INR 1,62,600 crores).
- ▶ Current capital budget in INR terms is ~6.7% higher than that of 2022-23 (BE).

Capital expenditure (INR crores)



Highlights



6.7%
increase in
Capital outlay
allocation and
15.9% in
revenue

Capital Budget allocation



Army: INR 37242 crores



Navy: INR 52805 crores



Air Force: INR 57137 crores

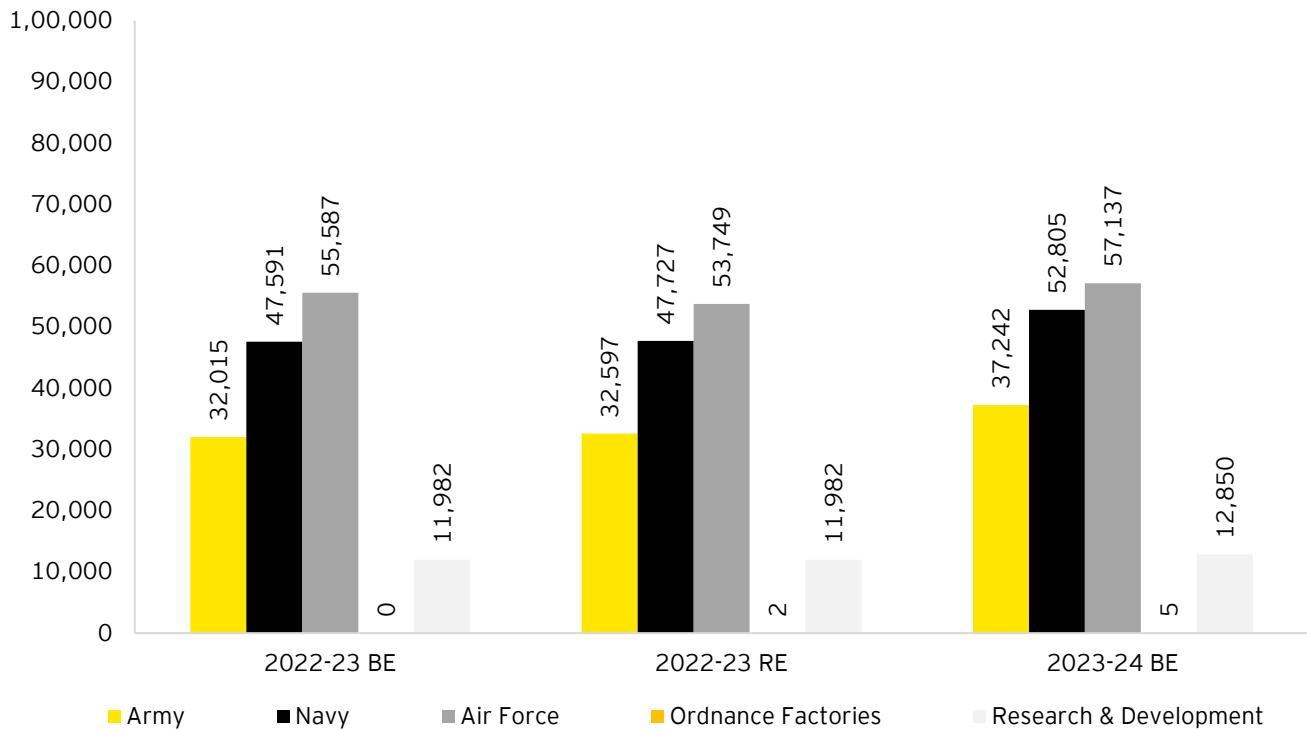


Agniveer Corpus fund to be created

- ▶ 30% matching contribution by the government
- ▶ Overall contribution and interest tax-free

- ▶ Indian Armed Forces have witnessed an increase in their capital budget over 2022-23 (BE). The increase in the capital budget of Indian Army, Indian Navy and Indian Air Forces is ~16%, ~10% and ~2.7% respectively.
- ▶ At 2022-23 RE stage, there is a reduction of ~1.5% from 2022-23 (BE).
- ▶ Closer examination of capital expenditure in INR terms for Indian Army shows an increase of ~165% for aircraft and aeroengines and ~65% increase for heavy and medium vehicles over 2022-23 (BE).
- ▶ For Indian Navy, there is an increase of ~18.12% for aircraft and aeroengines and ~200% for heavy and medium vehicles respectively. For other equipment, Indian Navy witnesses an increase of ~58% over 2022-23 (BE).
- ▶ Aircraft and aeroengines show a decrease of ~17% Indian Air Force and heavy and medium vehicles show an increase of ~351% over 2022-23 (BE).
- ▶ INR 5 crore has been allocated to erstwhile ordnance factories. There was no allocation in 2022-23 (BE).
- ▶ R&D budget has witnessed a ~7.2% increase over 2022-23 (BE).
- ▶ Assistance for prototype development under make procedure has witnessed a decrease of ~9.7% from 2022-23 (BE).

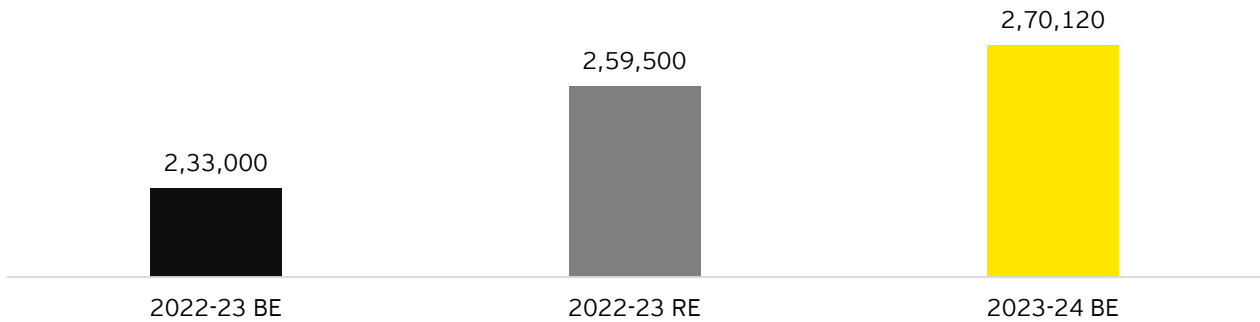
Breakdown of capital expenditure (INR crores)



Brief on Revenue Expenditure

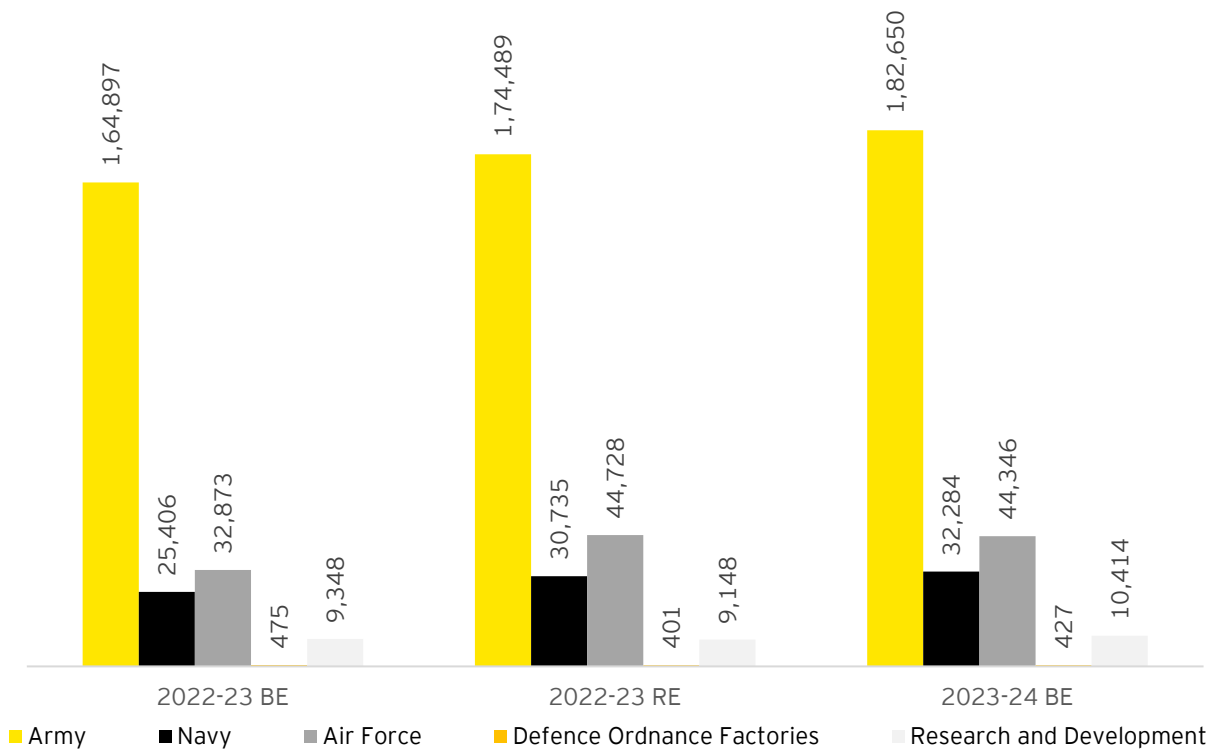
- ▶ Revenue budget estimates for 2022-23 have increased by ~15.9% as compared to 2022-23 (BE).

Revenue expenditure (INR crores)



- ▶ When measured in INR currency terms, Indian Air Force has witnessed the highest increase of ~34% in revenue budget amongst the Indian Armed Forces over 2022-23 (BE).
- ▶ Indian Army has witnessed an increase of ~10.7% and Indian Navy has witnessed ~27% increase of allocation during the same period.
- ▶ The total allocation across the three services for stores and works (and repairs and refits in case of Indian Navy) is INR 1,76,783 crores.
- ▶ A new budget head for Agnipath Scheme has been included in the revenue budget.

Breakdown of revenue expenditure (INR crores)



Notes and Explanations

- ▶ USD amounts for 2023-24 have been computed at INR 81.82 whereas USD amounts of 2022-23 have been computed at INR 74.81, as on 01 February of respective years.

Key amendments

▶ Direct Tax

- ▶ No changes to corporate tax rate
- ▶ Deduction of payments made to MSME's beyond statutory timeline to be allowed only on actual payment basis
- ▶ Sunset date for incorporation of start-ups to be eligible for tax holiday extended from 31 March 2023 to 31 March 2024
- ▶ Relaxation with respect to carry-forward and set-off of losses in case of start-ups, on change in shareholding proposed to be increased from a period of seven years to ten years
- ▶ Higher surcharge rate for individuals reduced from 37% to 25% under the new tax regime. Therefore, Effective Tax rate (ETR) on highest slab rate for individuals under new tax regime capped at 39% (earlier 42.74%)
- ▶ Slab rates have been amended under new personal tax regime, as under:

Total Income	
0 - 3 lakhs	Nil
3 lakhs - 6 lakhs	5%
6 lakhs - 9 lakhs	10%
9 lakhs - 12 lakhs	15%
12 lakhs - 15 lakhs	20%
Above 15 lakhs	30%

▶ Indirect tax

- ▶ Custom Duty
- ▶ Rate Rationalization
- ▶ Duty rate structure recalibrated for following goods without change to effective rate of Customs duty

Goods	Nature of Duty	From	To
1) Aeroplanes and Aircrafts (other than ones currently subject to Nil BCD or BCD of 2.5%)	Basic Customs Duty (BCD)	3%	2.50%
	Agriculture Infrastructure and Development Cess (AIDC)	0%	0.50%
2) Aircraft tyres (other than ones currently subject to Nil BCD)	Social Welfare Surcharge (SWS)	10%*	0%

▶ Extension of following key exemptions in relation to defence & aerospace

- ▶ Subject to review during the year, BCD exemption extended up to 31st March 2024 in relation to the following:
 - ▶ Aeroplanes/ other aircraft, their components/ parts and raw material for manufacture of aircrafts or its parts (covered by certain specified serial numbers of notification no. 50/2017-Customs dated 30.06.2017)
 - ▶ Exemption to Aircraft equipment, tanks, fuel and lubricating oils by Indian Air Force (covered by notification no. 151/94-Customs dated 13.07.1994)
 - ▶ Parts of aircraft imported under the Standard Exchange Scheme (covered by notification no. 23/2016-Customs 01.03.1996)
 - ▶ Imports relating to defence, internal security forces and air forces (covered by notification no. 37/2017-Customs dated 30.06.2017 and notification no. 39/96-Customs dated 23.07.1996)
 - ▶ Exemptions to firearms & ammunition by renowned shot (covered by notification no. 147/94-Customs dated 13.07.1994)
- ▶ BCD exemption in relation to import of challenge cups and trophies won by unit of Defence forces or its members extended for five years i.e. up-to 31st March 2028.

▶ **Goods and Services Tax (GST) Act**

- ▶ Input tax credit (ITC) shall not be available in respect of goods or services or both which are used or intended to be used as a part of corporate social responsibility.
- ▶ The government has restricted the registered person to file the GST returns after the expiry of three years from the due date of such returns.

▶ **Creation of Agniveer Corpus Fund**

- ▶ The Ministry of Defence introduced Agnipath Scheme in 2022 for enrolment of young youth In Indian Armed Forces (called as Agniveer). An Agniveer Corpus fund is proposed to be created to incentivize Agniveers under the Agnipath Scheme, 2022:
- ▶ Each Agniveer to contribute 30% of monthly package to this fund. Government will make matching contribution and also pay interest on overall contributions
- ▶ Consolidate amount (called Seva Nidhi) in the account will be paid to Agniveer on completion of 4 years of service
- ▶ These contributions shall be under E-E-E scheme i.e. both contributions will be tax free at the time of contribution, annual accretion through interest as well as at the time of withdrawal. Agniveer opting for new tax regime shall not be allowed deduction for own contribution

These amendments will take effect from the 1st day of April, 2023 and will apply in relation to assessment year 2023-24 and subsequent assessment years

▶ **Simplification of regulatory framework in GIFT IFSC**

- ▶ In 2021, Aircraft and Engine leasing activities were permitted in GIFT IFSC. To further enhance business activities in GIFT IFSC, various measures have been proposed to simplify the IFSC regulatory framework. These include:
 - ▶ Delegating powers under the SEZ Act to IFSC Authority (IFSCA) to avoid dual regulations
 - ▶ Setting up a single window IT system for registration and approval from various bodies such as IFSCA, SEZ authorities, GST, RBI, SEBI and IRDAI
 - ▶ Permitting acquisition financing by IFSC Banking Units of foreign banks
 - ▶ Amending IFSCA Act for statutory provisions for arbitration, ancillary services and avoiding dual regulation under SEZ Act

Impact analysis

The total MoD budget has witnessed a ~13% increase over 2022-23 (BE). For the purposes of this analysis, we are not discussing pay, allowances and pensions. Excluding the same, the MoD budget has increased ~12.29% over 2022-23 (BE).

Under Demand 19 i.e., Ministry of Defence (Civil), the budget head 'Secretariat General Services' has been allocated INR 2852.87 crores which translates to an increase of ~8.7% over 2022-23 (BE). This provision includes Grants for creation of Capital Assets for Defence Testing Infrastructure Scheme, Defence Corridors and Grant-in-aid for iDEX scheme. Therefore, an increased focus on development of Defence Corridors and GoI schemes including iDEX and DTIS is observed.

INR 5,000 crore has been allocated for 'Works under Border Roads Development Board'. Improved logistic support through new infrastructure along the north and north-eastern borders of the country finds constant momentum. MoD continues to invest in nine public enterprises with an allocation of INR 3,100 crore under Demand 19.

Under Demand 20 i.e. Defence Services (revenue), 'Stores' and 'Works' for the Armed Forces and also 'Repairs and refits' in case of Indian Navy, indicate the day-to-day maintenance of the inventory of the Indian Armed Forces. This amounts to INR 1,76,783 crores which is ~65.4% of the total revenue expenditure.

Substantial increase is observed for 'Heavy and medium vehicles' across the three services under the capital outlay. This appears to be in consonance to 'Green Growth' mentioned by Hon'ble FM in her speech.

Assistance for prototype development under make procedure has witnessed a decrease of ~9.7% from 2022-23 (BE). While allocation for 'Projects of the Army' witnessed no change, 'Projects of the Air Force' have witnessed a ~10% decrease. Increase of ~7.2% of R&D budget builds strongly over Government's commitment of allocation of 25% of R&D budget for industry, start-ups and academia.

Significant increase of allocation for 'Aircrafts and aeroengines' for the Indian Army may lead to acquisition of new rotary platforms. The decrease in the same for the Air Force indicates that no major acquisition is anticipated. At 2022-23 (RE) stage, an increase in allocation for 'Aircrafts and aeroengines' for the Air Force seems to be for the final payment of the last of the Rafale fighter aircraft.

A high capital outlay is provided for Land for the Indian Navy indicating expansion and development of naval bases. Indian Navy's allocation for 'Other equipment' has increased by ~58.3%. Therefore, acquisition of assets such as Naval Unmanned Aerial Systems (UAS) is foreseeable.

The tariff changes under customs are made with the intention of rationalising the existing tariff structure. Effective Customs duty on import of aeroplanes and aircrafts continue to be the same. Further, while Extension of certain exemptions in relation to Defence & Aerospace is a welcome change, however, the same shall be subject to review during the year. Given the Government's focus on Make in India, there is a possibility that some of the exemptions may be eventually phased out.

Glossary

iDEX - Innovations for Defence Excellence

DTIS - Defence Testing Infrastructure Scheme

MSME - Micro, Small and Medium Enterprises

ETR - Effective Tax Rate

BCD - Basic Custom Duty

GST - Goods and Services Tax

AIDC - Agriculture Infrastructure and Development Cess

SWS - Social Welfare Surcharge

ITC - Input Tax Credit

IFSC - International Financial Service Centre

IFSCA - International Financial Service Centre Authority

SEZ - Special Economic Zone

RBI - Reserve Bank of India

SEBI - Securities and Exchange Board of India

IRDAI - Insurance Regulatory and Development Authority of India



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