India Insights

COVID-19 and beyond

April 2020
The COVID pandemic has shaken-up societies across the world, with considerable human and social disruption. It has led to an unprecedented economic crisis, with the total and prolonged lockdown affecting supply and demand as investment plans have completely halted, corporate and household spending have reduced to bare levels, and multiple sectors are facing job losses. Certain sectors including MSMEs, tourism, hospitality, aviation, automotive, real estate and textiles have been particularly vulnerable to the shock.

India’s policymakers have swiftly responded to the crisis with proactive steps taken to contain its spread and have provided policy support to ensure survival, solvency and stabilisation in these times of radical uncertainty. However, given the serious setback to the economy at a time it was already slowing down, the government must push forward its next tranche of stimulus packages to complement its earlier measures.

An analysis carried out by EY’s Tax and Economic Policy Group shows that in these extraordinary times, casting aside fiscal prudence, the government should consider relaxing the fiscal deficit target for 2020-21 from 3.5% of GDP to up to 8-9% of GDP. After accounting for the stimulus package already announced till date and adjusting for the expected tax revenue and disinvestment receipts shortfall for FY 2020-21, the government may have an additional fiscal space of up to Rs 4.3 to 5.8 lakh crores. Out of this, a stimulus package of Rs. 2.2 lakh crores could be frontloaded for providing solvency support for businesses.

Sudhir Kapadia
National Tax Leader, EY India
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Senior Professionals, Tax and Economic Policy Group, EY India

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The COVID-19 pandemic continues to create stress and uncertainty across the world. Social distancing and lockdowns have brought economic activities to a standstill, with serious implications on the livelihoods of people at large, as well as businesses. In India, the government swiftly responded to the crisis and announced several relief measures, particularly for the vulnerable sections of the society. However, as the economic impact of the pandemic deepens, it is time to introduce the next tranche of supportive stimulus package to complement the earlier measures.

Navneeraj Sharma and Chinmaya Goyal
Senior Professionals, Tax and Economic Policy Group, EY India
Businesses in India are going through a massive liquidity and financial shock. A recent study by EY Tax and Economic Policy Group, analyzed the levels of fixed costs faced by top 8,700 non-financial companies with total operating revenue of INR 134 trillion. Though lockdown reduces or eliminates operating revenues, businesses still bear fixed costs like wages and salaries, interest, rent and depreciation. In the sample of 8,700 companies, as per latest data available from EMIS, the median employee and interest payment came out to be 8% of operating revenue, excluding other fixed costs like rent. Thirty percent of the companies were also found to have less than two months of cash for paying salaries to their employees. Thus, restrictions on economic activity will continue to exert stress on the financial health of companies. This downward spiral in the financial health of the companies, if not tackled timely, can bring along new challenges and may cause prolonged economic slowdown.

To tackle the liquidity problem, the Reserve Bank of India (RBI) has undertaken a slew of measures since the national lockdown on 22 March to tackle the liquidity problem. It has provided for an optional three-month loan repayment moratorium and has injected large amounts of liquidity in the financial system. However, monetary policy alone is not enough to address the current challenges. Fiscal policy is also essential to complement the RBI measures. This is not the first time that India is undergoing such a crisis. The 2008 financial shock was also one of a kind situation. At that time, the then Indian government provided a stimulus of 3.5% of GDP to put the economy back on track. The current crisis is even graver and it calls for a greater stimulus. Considering the severity of the pandemic's impact, the government may consider relaxation of its fiscal deficit target for FY 2020-21 by about 5% of GDP which will cover shortfall in revenues and provide resources for an economic stimulus. We estimate that for FY 2020-21, the government may have an additional fiscal space of up to Rs 4.3 to 5.8 lakh crores. Out of this, a stimulus package of Rs 2.2 lakh crores could be frontloaded for providing solvency support for businesses.

Enabling greater flow of credit to the affected sectors

The RBI’s measures, though well-intentioned, are not enough to ensure flow of credit to the affected sectors. There is a likelihood for banks to perceive risks in lending to businesses in the affected sectors. Owing to this, they might either stop lending or may offer loans at a very high rate. The RBI has already been supporting the corporate sector by organizing Long Term Repo Operations (LTRO) for banks on the purchase of corporate bonds. However, that is not enough. It is essential for the government to step up their support towards the central bank by creating a bond buying fund under institutions such as the State Bank of India (SBI) and Life Insurance Corporation (LIC). This may provide short-term support to the severely-affected sectors whose bonds may not be credit worthy due to COVID-19. This fund may help in protecting long-term value created by these companies.

To address the liquidity needs of the Micro, Small and Medium Enterprise (MSME) sector, the government could provide a direct credit support by setting up a credit guarantee fund, in partnership with banks, to enable them to lend. The EY study estimates that a provisioning of INR 22,500 crores by the government can enable additional credit of about INR 3 lakh crores. Additionally, the government may introduce an extended interest subvention scheme on fresh loans to the MSME sector.

Protecting jobs by covering partial fixed costs in the affected sectors

The extended credit lines may not be enough to restore badly-affected sectors and may also reduce the chances for them to repay the loans. Therefore, the government’s support may be needed to provide direct relief to these sectors in preventing large job losses. This includes MSMEs in industrial sector, transport operators, aviation, tourism, hotel and restaurants, wholesale/retail trading, textiles, apparel, leather and electronics. The government’s direct intervention, in terms of partial payment of interest and salary costs, can also go a long way in protecting the jobs.

For e.g., to support these sectors it may be necessary to pay 50% of the next three months interest burden. This relief can be made contingent on providing job security to their employees. Similarly, a wage support scheme to the firms in the affected labor-intensive sectors may be effective as companies are continuing to pay salaries to their employees without having any cash flow during these turbulent times. A wage subsidy of INR 2,000 per month per employee for next three months may help the long-term livelihood of seven crore employees. This intervention can go a long way in protecting the economy as well.

Besides these measures, some specific steps are also required for sectors like aviation, construction, tourism and leisure, automobile, mining, transportation, and infrastructure.

So far, the government’s response to manage the economic impact of COVID-19 has been swift and robust. Going forward, the direct solvency support will be imperative for the vulnerable businesses in their fight against the pandemic and to combat irreversible economic dislocation.
Multilateral institutions have assessed that the COVID-19 global pandemic will leave the world economy worse off than the 2009 global economic and financial crisis. Its impact may be more comparable with the Great Depression of 1929. The International Monetary Fund (IMF) has projected global GDP to contract by (-) 3% in 2020 with advanced economies (AEs) expected to contract by (-) 6.1% and emerging market and development economies (EMDEs) by (-) 1.1%. Two major EMDEs namely India and China are expected to show a low but positive growth respectively at 1.9% and 1.2% respectively in 2020. Other institutions and rating agencies project the global growth in 2020 to range from (-) 2.7% (Bank of America) to 1.95% (mid-point of range provided by OECD).
The COVID-19 induced economic crisis is quite different from the 2009 global economic and financial crisis in some crucial respects. The roots of the 2009 crisis emanated from the housing market crisis of the US and excessive lending by global financial institutions to households based on poor quality collaterals. The credit markets across the world crashed, leading to a collapse of credit demand across countries. This was a demand-led crisis and it was addressed by individual and coordinated stimulus across the G-20 countries.

These countries coordinated their stimulus action by reducing interest rates and by increasing their debt-financed government expenditures. In some of the economies where this was overdone, there was a sharp rise in inflation. The longer-term outcome was an increase in the indebtedness of the whole world.

Since the COVID-19 crisis may be deeper than the 2009 crisis, the reliance on fiscal measures would be even larger. In fact, in most developed countries, the interest rates are near zero and any monetary side stimulus may have limited effect. As such, it is the borrowing-based financing of government expenditure which will serve to boost demand in different countries. However, the current crisis is a combination of supply side disruptions and a sinking of demand. As demand is uplifted through stimulus, supply side disruptions may have to be simultaneously removed so that the two sides may come out of the crisis in sync. This calls for a carefully calibrated injection of demand stimulus which should be synchronized with the stages of the exit from the lockdown.

India’s current growth prospects are highly constrained as it has entered the COVID-19 crisis on the back of an economic downslide. The real GDP growth was estimated at 5% for FY20 as per the earlier CSO release dated 28 February 2020. As more recent information for 4QFY20 becomes available, this estimate may go down significantly. The IMF has projected India’s FY20 growth at 4.2% and its FY21 growth at 1.9%. Other multilateral institutions have projected India’s FY21 growth to range between 0.8% (Barclays) to 4% (ADB) with the median growth rate at 2.4%.

High frequency indicators highlight the unfolding adverse impact of the COVID-19 pandemic. Growth in goods exports contracted by (-) 34.6% in March 2020, the highest pace of contraction in nearly three decades. Power consumption which was already contracting by (-) 4.0% over the period August 2019-January 2020 further contracted by (-) 7.0% in March 2020. During the first phase of the lockdown period from 22 March 2020 to 4 April 2020, it fell even more sharply by (-) 24.2% indicating a steep fall in economic activity. Retail sales of automobiles contracted to its historic low of (-) 44.95% led by a sharp decline in the sale of passenger vehicles and two-wheelers by (-) 51.0% and (-) 39.83% respectively in March 2020 as per the latest data released by Society of Indian Automobile Manufacturers. Growth in bank credit fell to 6.1% in the fortnight ending 27 March 2020, its lowest level since the fortnight ending 18 August 2017. Growth in bank credit has been falling in each subsequent fortnight since 3 January 2020. Gross tax revenues of the center contracted by (-) 0.8% during April-February FY20 with direct taxes contracting by (-) 3.5% and indirect taxes witnessing a subdued growth of 1.6%. PMI services also contracted to 49.3 in March 2020 from its 85-month high of 57.5 in February 2020. Some rating agencies have predicted a contraction for India in FY21. Both Goldman Sachs and Nomura estimate it to be (-) 0.4%.
Fighting our way out: policy stimuli and preparing for the new normal

a. Policy stimuli

On the monetary side, the repo rate was reduced to a historic low of 4.4% on 27 March 2020. Numerous liquidity-augmenting and regulatory measures have also been undertaken since then. Liquidity augmenting initiatives include a reduction in the CRR, targeted long-term repos operations (TLTROs), reduction in the reverse repo rate, special refinance window for all India financial institutions, and eased overdraft rules for state governments. The RBI also increased the limit under ways and means advances (WMAs) for the central and state governments. In TLTRO 2.0 (aggregate amount of INR 50,000 crores) that was announced by the RBI on 17 April 2020, it was mandated that the funds must be invested in investment grade bonds, commercial paper, and non-convertible debentures of NBFCs, with at least 50% of the total amount availed going to small and mid-sized NBFCs and MFIs. The regulatory initiatives of the RBI include permitting commercial banks and financial institutions to provide moratorium of three months on payment of instalments in respect of all term loans outstanding as on 1 March 2020 and deferment of interest on working capital facilities for three months on all such facilities.

While the need for a large fiscal stimulus to support relief and stimulus measures is paramount, the available resources for the government appear to be highly constrained when we match the public sector borrowing requirement (PSBR) with the sources of its financing. India has stepped into the COVID-19 crisis at a near-standstill. As and when economic activities resume, they may not normalize for a long period of time. In fact, the resumption of activities needs to be according to a well-thought out exit strategy. Different output sectors may resume activities at different pace as the health pandemic is gradually brought under control. Sectoral targeting of fiscal stimulus should be synchronized with the opening up of the relevant sectors. India's FY21 growth would depend critically on the pace of opening up of the sectors and the extent of stimulus.

India is far more handicapped at present as compared to the 2009 crisis when we experienced five successive high growth years over the period FY04 to FY08. The average growth rate during this period was 7.9%. In FY08, the combined fiscal deficit of the central and state governments was also at its lowest at 4.1% of GDP.

As compared to the FY21 budget estimates (BE), both the central and state governments would suffer a significant revenue erosion due to the lower FY20 tax base and lower growth prospects in FY21. Factoring in the lower GDP growth and slippage in tax revenues and non-debt capital receipts as compared to BE, the slippage may amount to a minimum of 2.4% of GDP considering centre and states together. Considering an additionality of 0.3% of GDP in the relief package of INR 1.7 lakh crore announced under the Pradhan Mantri Garib Kalyan Yojana, the combined fiscal deficit may have to be increased from 6.5% to 9.2% of GDP just to meet budgeted expenditure. Providing for additional stimulus spending of 3% of GDP for the central government, 1% of GDP for the state governments, and a borrowing requirement of 3.5% of GDP by the central and state public sector enterprises (PSUs), the total PSBR is estimated at 16.7% of GDP. Against this, the available sources of financing consisting of excess savings from household and private corporate sectors (7% of GDP), savings of the public sector (1.5% of GDP) and current account deficit (1% of GDP) add to only 9.5% of GDP, leaving a significant financing gap of 7.2% of GDP. Some of the channels through which this gap may be filled up include monetization of fiscal deficit, borrowing from multilateral institutions including the IMF, and borrowing from NRIs.

b. Exit strategy

India's first three-week lockdown which was slated to end on 14 April 2020 has now been extended up to 3 May 2020. In the month of April 2020, the economy was at a near-standstill. As and when economic activities resume, they may not normalize for a long period of time. In fact, the resumption of activities needs to be according to a well-thought out exit strategy. Different output sectors may resume activities at different pace as the health pandemic is gradually brought under control. Sectoral targeting of fiscal stimulus should be synchronized with the opening up of the relevant sectors. India's FY21 growth would depend critically on the pace of opening up of the sectors and the extent of stimulus.

Contributions by:
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Ragini Trehan and Tarrung Kapur
Senior Professionals, Tax and Economic Policy Group, EY India
The COVID-19 pandemic is likely to be that inflection point in the history which changed the nature of the post-World Trade Organization (WTO) global trade policy environment. The last time the world witnessed a similar situation was in 1995 when the WTO was established, creating a rule-based global trading system. As of December 2019, when China first informed the World Health Organization (WHO) about the corona virus\(^1\), the last of the judges at the Appellate Body of the WTO retired without their replacement being appointed by the WTO Members. This, in effect, has removed the most important tool by which the order was maintained by the WTO, impacting its ability to ensure adherence to its rules by its members.

The impact of COVID-19 on trade and economy is already visible. It has led to reduction in demand and collapsing trade flows. Supply-chain disruptions have questioned the resilience of production networks, whether regional or global, on which the world has been dependent on in the post-WTO period. Economists are comparing the lockdown with the Great Depression of 1930s and the financial crisis of 2008-09.

The WTO estimates world trade to fall by 13% to 32% in 2020.

Global institutions are trying their best to soften the impact of this pandemic on the world’s economy. The World Bank has released a guidance note on Dos and don’ts of trade policy in response to COVID-19. The note encourages governments across the world to ease out the restrictions for trade in essential medical goods and food, by removing the need for applications, licenses, etc. It further encourages them to support exporters to maintain jobs and foreign exchange earnings, and to contribute to macroeconomic policy efforts to shield the economy from the downturn caused due to the pandemic. Whether countries heed this advice, or the protectionist tendencies strengthen is the question to ask.

Even before the pandemic struck, there were a series of disruptions in the global trade policy environment, led by unilateral and sometimes arbitrary actions. These were in the form of imposition of punitive import duties, withdrawal of Generalized System of Preferences (GSP) benefits and renegotiation of free trade agreements by a few countries. In India, too, the signs of the trade policy turning inward-looking were appearing.

These signs include India’s hesitation in signing on to the Regional Comprehensive Economic Partnership (RCEP) Agreement without inclusion of specific measures to protect its interests, increase in anti-dumping and other trade protection actions and increasing its import duties and new import licensing requirements.

In the post-pandemic environment, many countries are likely to intensively dedicate their efforts towards rebooting their industries and protecting their vital and essential supplies. Ensuring availability of essentials for the future in case such a pandemic situation arises, can be achieved by protecting their critical domestic industries and diversifying their supply chains, both of which would require targeted policy measures. Trade policies can, thus, be expected to become more conservative.

The conservative approach is likely to be reflected in the national trade policy of countries in multiple ways, such as by increase in import tariff and covert or overt non-tariff barriers like licensing procedures, import and export quotas, and in maintenance of their strategic reserves. Countries may also look to defend their existing domestic industries through increased recourse to trade remedial measures, such as, antidumping duties, anti-subsidy duties and safeguard duties. This would be necessary for the domestic industries, not inherently efficient, to retain their profitability.

For India, the rising global uncertainties relating to the existing supply chain, including their competition with China, might surprisingly bring them an array of opportunities post the pandemic. Several reports suggest that some American and European manufacturers intend to relocate their factories out of China or at least have alternate sources in geographically diverse locations. Japan is reported to be offering support to its industries to relocate back home. Going forward, this may provide a good opportunity for India to attract foreign manufacturers to relocate their factories here. To this end policy measures that include focused investments in infrastructure and incentive measures that offset the inherent problems of operating here will be necessary. Creating a foreign investment-friendly policy environment, focusing on sectors that amongst other objectives, would also substitute India’s import needs, may be India’s best bet to get a head-start in reviving the economy.

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It will be interesting to see how the world will deal with me-first trade policies, especially with the WTO not in a position to enforce its own rules.
COVID-19: Sectoral impact and recommendations
Impact of lockdown and risks

- Automobile production projected to fall by more than 8% in 2020 (Fitch)
- Lower transportation use and bottlenecks in auto loans will also impact automobile sales
- Also affected by lower imports of automobile and parts, and shutting down of key exports markets
- Fixed costs as a proportion of total operating revenues for top companies:
  - Employee costs: 8%
  - Depreciation: 2%
  - Interest cost: 1%
  (Median for 918 companies)

Source: EMIS Database

As per SIAM, auto sector value chain is 7% of India’s GDP @ US$200B approximately with Suppliers on one side, OEMs in middle, Dealers on other side and Financial Institutions

<table>
<thead>
<tr>
<th></th>
<th>Share in GDP</th>
<th>Share in employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing of automotive</td>
<td>2%*</td>
<td>0.3%</td>
</tr>
<tr>
<td>Wholesale or retail trade</td>
<td>NA</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

* Source: National Accounts Statistics, PLFS survey 2017-18

Policy recommendations by EY

- “Cash for Clunkers” program could be introduced. It will help sell more fuel-efficient vehicles
- Encourage state governments to waive off vehicle registration charges
- Introduce a new window for lower interest for auto loans through an interest subvention scheme for commercial vehicle, small value cars, and electric cars for the period of six months
- Aid the 25000 car dealers as they work on thin margins by making them part of the auto sector bailout package
- GST on EV battery charging service and battery supplied be taxable at a rate of 5%
Impact of lockdown and risks

- Shutdown affecting construction leading to cost overruns
- Slowdown in consumer demand and resultant liquidity crunch
- Risk of default in mortgage loans and possible squeeze in lending
- Affordable housing projects may particularly face issues due to informal sector getting affected from the lockdown
- Being capital intensive, this sector has relatively higher interest costs compared to others
- Fixed costs as a proportion of total operating revenues for top companies:
  - Employee costs: 6%
  - Depreciation: 3%
  - Interest cost: 3%
  (Median for 1159 companies)

Source: EMIS Database

<table>
<thead>
<tr>
<th>Number of months of cash available for employee salary</th>
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</thead>
<tbody>
<tr>
<td>Less than 1</td>
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<td>1-2</td>
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<tr>
<td>2-4</td>
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<tr>
<td>4-6</td>
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<tr>
<td>Greater than 6</td>
</tr>
</tbody>
</table>

1. Companies with zero or negative equity have been excluded.
2. Data for other fixed costs such as rent is not available.
   Source: EMIS Database

<table>
<thead>
<tr>
<th>Impact and recommendations</th>
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<tbody>
<tr>
<td>Share in GDP</td>
</tr>
<tr>
<td>Construction</td>
</tr>
<tr>
<td>Real estate and ownership of dwellings</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: National Accounts Statistics, PLFS survey 2017-18
Impact of lockdown and risks

- Waiver of interest for a period of 3 months on home loans taken for projects under Pradhan Mantri Awas Yojana (PMAY) - Rs 11,000 crore
- Double the funding for “Special Window for Funding Stalled Affordable and Middle-Income Housing Projects” to Rs. 50,000 crores and expeditiously deploy it for managing the stalled projects
- Implement NITI Aayog proposal of 75% award of current amount stuck in arbitration with the Government or Government entities without the requirement of bank guarantee to be given by the recipient - Rs 35,000 crore
- Permit GST paid on inputs in construction of commercial property to be paid as credit for GST charged on rentals
- Encourage states to waive off stamp duty in major metropolitan areas for the next 9 months to boost demand
- Reduce incidence of stamp duty on transaction documents pursuant to a sale and leaseback transaction
- Encourage states to defer municipality taxes and other fees like IDC/EDC (internal development charge/external development charge) etc. for the period of next 6 months
- To encourage sale and leaseback transactions, permit the lessee to claim an expense deduction under the Income tax Act, 1961 for lease rental payments. Also, the lessor should be allowed to claim tax depreciation on the acquisition price as it relates to “depreciable asset”. These measures will help unlock capital for the sector.
Impact of lockdown and risks

- Passenger transport services across land, air and water closed
- Freight transport only partially open (e-commerce)
- Post lockdown also, demand is expected to be low
- The transport sector accounts for large employment, especially in the informal sector
- Fixed costs as a proportion of total operating revenues for top companies:
  - Employee costs: 7.7%
  - Depreciation: 3.7%
  - Interest cost: 1.6%
  (Median for 644 companies)

Source: EMIS Database

<table>
<thead>
<tr>
<th>Transport</th>
<th>Share in GDP</th>
<th>Share in employment</th>
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<tbody>
<tr>
<td>Land transport</td>
<td>3.06%</td>
<td>4.63%</td>
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<tr>
<td>Air transport</td>
<td>0.15%</td>
<td>0.02%</td>
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<tr>
<td>Water transport</td>
<td>0.75%</td>
<td>0.03%</td>
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<tr>
<td>Logistics</td>
<td>0.76%</td>
<td>0.25%</td>
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<tr>
<td>Total</td>
<td>4.72%</td>
<td>4.93%</td>
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</table>

Source: National Accounts Statistics, PLFS survey 2017-18

Policy recommendations by EY

- Include Aviation Turbine Fuel (ATF) in GST
- Pending that, waive off excise duty on ATF without an interest payment for next three months
- Pass through the further fall in the prices of the petroleum products to consumers
- Government may infuse capital (in the form of preferred shares) in the aviation sector for bailing out the companies
Impact of lockdown and risks

- Severe impact of lockdown on domestic and foreign tourism and leisure activities, with a possible slow recovery
- Hotel occupancy rates to decline from 66% to 40% in this year (CARE Ratings)
- Very high fixed costs for the sector, especially employee costs, as a proportion of total operating revenues:
  - Employee costs: 20%
  - Depreciation: 7%
  - Interest cost: 3%
  (Median for 554 top companies)

Source: EMIS Database

Policy recommendations by EY

- Further, a special grant/package for companies in tourism and hospitality sectors to cover at least 30% of employee cost, initially up to 30 June, 2020—Rs 13500 crores
- Reduce the GST rate on hotel accommodation to 5% for tariff up to Rs. 7,500 and 12% on other rooms at least for a year

Impact and recommendations

<table>
<thead>
<tr>
<th></th>
<th>Share in GDP</th>
<th>Share in employment</th>
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<tbody>
<tr>
<td>Hotels and restaurants</td>
<td>1%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Tour operators, travel agency and other related services</td>
<td>NA</td>
<td>0.1%</td>
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<tr>
<td>Total</td>
<td>NA</td>
<td>2.0%</td>
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Source: National Accounts Statistics, PLFS survey 2017-18

Number of months of cash available for employee salary

<table>
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<tr>
<th></th>
<th>Less than 1</th>
<th>1-2</th>
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<tr>
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<td>28</td>
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1. Companies with zero or negative equity have been excluded.
2. Data for other fixed costs such as rent is not available
Source: EMIS Database
Impact and recommendations

**Mining and metals**

Mining and metals sector is being impacted from twin issues of (i) lower global commodity demand and prices, and, (ii) slowdown in key user sectors (for example, automobile and construction in case of iron and steel)

- Fixed costs for the sector as a proportion of total operating revenues:
  - Employee costs: 3%
  - Depreciation: 1%
  - Interest cost: 1%

(Median for 942 top companies)

Source: EMIS Database

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**Impact of lockdown and risks**

<table>
<thead>
<tr>
<th></th>
<th>Share in GDP</th>
<th>Share in employment</th>
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<tbody>
<tr>
<td>Mining</td>
<td>2%</td>
<td>0.4%</td>
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<tr>
<td>Manufacturing of metals and products</td>
<td>2%</td>
<td>1.9%</td>
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<tr>
<td>Total</td>
<td>4%</td>
<td>2.3%</td>
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Source: National Accounts Statistics, PLFS survey 2017-18

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**Number of months of cash available for employee salary**

<table>
<thead>
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<th>Months of cash available</th>
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<th>63</th>
<th>28</th>
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<tbody>
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<td>Less than 1</td>
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Source: EMIS Database

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**Policy recommendations by EY**

- Waiver of payments on royalty and contribution towards districts mineral funds for a period of three months
- Waiver of cess & other taxes on oil production for a period of three months (Rs. 9,000 crores)
- Mining and metals sector could be provided with deferment of electricity charges as they are heavy consumer of power
- Regular monitoring of imports and expanding the intervention required to other grades of steel
- Reduce the import duty on coking coal and compensation cess on coal (Rs. 2,500 crores)
Adverse impact of COVID-19 on ‘under-construction’ infra projects - disruptions to supply of materials and inputs, labour, cash-flow and other ancillary sectors

~ 79% of the total infra projects in India are in the ‘under-construction’ stage amounting to US$236.6 bn or 8.2% of GDP

Under-construction infra-projects in the transport sector entail the highest cost at US$ 89.6 bn, ~ 3.1% of FY20 nominal GDP (Chart 1)

By type, government infra projects (traditional procurement) accounts for 75% of total cost of under-construction infra projects (Chart 2)

Impact of lockdown and risks

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Impact and recommendations

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Chart 1: Sector wise cost of under-construction projects as % of FY20 nominal GDP (8.2%)

Transport: 3.1%, Energy: 2.8%, Water Sanitation: 2.1%, Social and Commercial Infrastructure: 0.2%, Communication: 0.1%

Chart 2: Cost of under-construction infra-projects by type - as % of FY20 nominal GDP (8.2%)

Government Infrastructure Projects (PPP): 0.92%, Government Infrastructure Projects (Traditional Procurement): 6.18%, Private Sector Infrastructure Projects: 1.13%
Frontloading government capital spending through unutilized cess amounts; targeted support to private and Public-Private Partnership projects (PPP)

Impact of lockdown and risks

Policy recommendations by EY

- Kick-starting the economy will require revival of infra-sector which may come from frontloading government capital spending on currently stalled under-construction government infra projects. (government non-defence capital expenditure multiplier is estimated at 1.81 (RBI, 2013))
- Private sector and PPP infra projects: based on viability analysis, targeted line of credit from the proposed ‘credit guarantee fund’ may be provided; faster approvals for funds
- Set up task force to clear major infrastructure projects currently stuck in NGT or due to tribunal proceedings, such that construction can be initiated

Possible funding mechanism

- Unutilized amounts under Central Road and Infrastructure Fund - estimated at over INR1 lakh crore at the end of FY20
- Unutilized amounts under Health and Education cess estimated to be in excess of INR1 lakh crore at the end of FY20
- Incentivise investment in India’s infrastructure sector by Sovereign Wealth Funds and Pension Funds by widening the gamut of infrastructure activities eligible for the exemption and provide a simple and time bound process for granting the exemption
Impact and recommendations

National Infrastructure Pipeline (NIP): rethinking sectoral priorities – emphasis on health

- Rethinking sectoral priorities under NIP
  - Increasing share of investment in medical health and education research
  - Prioritization should be brought forward for spending on health infrastructure including medical research
  - Stimulus to construction and transport and communication sectors by frontloading capital spending in the initial years of NIP
  - Given that health is a state subject, the centre may consider providing a special grant to states in FY21 to cope with this unanticipated outbreak

Possible funding mechanism

Unutilized amounts under Health and Education cess estimated to be in excess of INR 1 lakh crore at the end of FY20

<table>
<thead>
<tr>
<th>#</th>
<th>Sectors</th>
<th>FY18 Estimates</th>
<th>NIP (FY2020-FY25)</th>
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<tbody>
<tr>
<td>1</td>
<td>Agriculture</td>
<td>1.4</td>
<td>8.1</td>
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<tr>
<td>2</td>
<td>Mining</td>
<td>1.4</td>
<td>-</td>
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<tr>
<td>3</td>
<td>Manufacturing</td>
<td>2.5</td>
<td>0.1</td>
</tr>
<tr>
<td>4</td>
<td>Electricity and other related services</td>
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<td>5</td>
<td>Construction</td>
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<tr>
<td>6</td>
<td>Trade, hotels and other related services</td>
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<td>2.9</td>
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<tr>
<td>7</td>
<td>Transport and communication</td>
<td>18.1</td>
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<tr>
<td>8</td>
<td>Financial services and other related services</td>
<td>16.7</td>
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<td>9</td>
<td>Real estate services</td>
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<td>10</td>
<td>Medical Health and education research</td>
<td>12.9</td>
<td>3.5</td>
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<td>11</td>
<td>Public admn.*</td>
<td>12.1</td>
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</tr>
<tr>
<td></td>
<td>Total</td>
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</tr>
</tbody>
</table>

Sectoral share (%) of infrastructure investment: Comparison with FY18 estimates

Source (Basic data): National Infrastructure Pipeline, Government of India, MoSPI
*excludes health and education

Policy recommendations by EY
Impact and recommendations

Further support to the financial sector to sustain the flow of credit and financial stability

- NBFCs may not be able to avail the loan moratorium as most of their debt is raised through capital markets. However, they will have to provide moratorium to their customers, creating a cash flow mismatch. Therefore provide
  - 20% of total liquidity of Rs 237,000 crores for NBFCs
  - Mandatory flow of a fixed share of liquidity to NBFCs through TLTRO operations
- For NPA classification, 3 months moratorium on bankruptcy may include financial institutions following IND AS accounting standards
- Extend LAF window for NBFCs and Mutual Funds who have systemic importance
- SEBI may relax the 6 month average pricing rule for raising money from capital markets
- Current option of moratorium of loans provided till June 2020 to be extended up to August 2020
- Under its Economic Capital Framework, RBI may use its available risk buffers to manage the financial instability

Sector wise % of total non-food credit

<table>
<thead>
<tr>
<th>Sector</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSMEs</td>
<td>14</td>
</tr>
<tr>
<td>Consumer goods &amp; retail</td>
<td>4.9</td>
</tr>
<tr>
<td>Real estate &amp; construction</td>
<td>4.1</td>
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<tr>
<td>Mining and iron/steel</td>
<td>3.3</td>
</tr>
<tr>
<td>Automotive</td>
<td>2.6</td>
</tr>
<tr>
<td>Transport</td>
<td>1.4</td>
</tr>
<tr>
<td>Tourism and leisure</td>
<td>0.5</td>
</tr>
<tr>
<td>Consumer electronics</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Total Non-Food Credit at USD 1.6 trillion

Source: RBI Database
A gig economy is a digital labour and talent market helping organizations meet their workforce demand for short-term engagements by hiring independent workers via online platforms that connect gig (temporary) worker with the organization.

**Will COVID-19 accelerate adoption of the talent marketplace model?**

With everyone in lockdown mode, organizations and their people across sectors and across levels, have accelerated adoption of online collaboration platforms. While a lot is being said and done to focus on health and safety of people and the potential impact to the economy, sub-consciously, the talent in each organization has adapted to a new way of working.

This transformation enabled by online platforms has created the framework for the gig economy.

**What is gig economy?**

- Organisations seeking talent for short term assignments
- Online platform connecting the service recipient and provider
- Free lancers/ contingent workforce offering goods/services for a price

Ajit Krishnan
Partner and Tax Talent Leader, EY India
A gig worker is not bound by an employment contract rather is engaged on a task-based assignment connected via an algorithmic matching system. The gig workers can work for multiple organizations at any given point in time.

**Tax and regulatory implications**

**For talent marketplace**

**Taxability**

An online talent marketplace, which qualifies as a non-resident e-commerce operator (ECO), would be subject to Equalisation Levy (EL) at the rate of 2% on consideration received or receivable against e-commerce supplies or services (provided such amount exceeds ₹20 million). The income on which such EL has been paid will be exempt from income-tax.

The non-resident ECO will have to ensure payment of EL to the Government treasury on a quarterly basis and will have to file an annual return to report such amount(s) deducted and deposited with the Government.

Where online talent marketplace is a resident, the income would be subject to tax as its business income. Taxes would be appropriately withheld under domestic law provisions by the buyer depending on nature of services rendered.

**Withholding obligations**

To widen and deepen the tax net, government also introduced withholding tax obligation on ECO for sale of goods or provision of service facilitated by it through its digital or electronic facility or platform (@1% on the gross amount paid to the e-commerce participant subject to an exception for individuals/ HUFs in some cases).

However, if gig workers qualify as employees, withholding would be required to be undertaken as salary payment.
The contract/arrangement between the online talent marketplace and gig workers would need careful evaluation to determine whether the gig workers qualify as dependent or independent workers and whether payment received by such gig workers would be taxable under salary or professional fees. This could influence the preference of such individuals.

**Labour laws/social security benefits**

Applicability and consequences under labour laws, social security regulations, minimum wage guarantee, etc. would need to be evaluated depending upon whether gig workers are resident or non-resident and whether such gig workers qualify as 'employees', which would in turn depend on factors such as control over a gig worker, supervision and right to initiate disciplinary action.

**GST implications**

In case a gig worker has an aggregate income of ₹2 million\(^2\) and below, there is no requirement of GST registration.

Registered gig workers will be required to discharge GST at applicable rate, on services rendered to buyers through talent marketplace, provided place of supply of such services is in India. GST compliances would also need to be undertaken.

1% TCS collected and deposited by the talent marketplace will be available as credit to the seller.

For organizations availing services of gig workers

**Deductibility & withholding**

Payments made by organizations to platform operators should be deductible as business expense, however, such payments would be subject to withholding depending on whether the talent marketplace is resident or non-resident.

**GST implications**

GST registered buyers should be eligible to take input credit of the GST charged by the seller or talent marketplace.

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1. Legal, Medical, Engineering, Architectural profession, Accountancy, Technical consultancy, interior decoration and other professions as may be notified

2. ₹1 million and below for certain special category States
Legal implications on talent marketplace model

**For talent marketplace**


The code recognise 'gig workers' and 'platform workers' and stipulates framing of welfare schemes for such workers. The talent marketplace may be required to make contributions in this regard and undertake compliances, once the code is notified.

**Terms of engagement agreement**

Prolonged term of engagement, right to terminate, supervision or control by platform operator may accrue status of an employee to a gig worker thereby entitling the worker to employee benefits under Indian laws. Hence, the engagement agreement needs to be drafted carefully.

**Non-compete/ solicit**

Non-compete, non-solicit clauses may need to be drafted appropriately, considering ability of gig worker to work on various platforms.

**Confidentiality**

Stringent confidentiality obligations regarding information belonging to platform operator and/or customers may need to be expressly enumerated.

**Intellectual property**

Right of ownership over intellectual property related to work product may become a challenge and may be mitigated by expressly stipulating in the engagement agreement.

**Compliance in multiple jurisdictions**

Compliance with varied laws of different jurisdictions as well as industry specific laws may be required.

**Data privacy laws**

The talent marketplace, as well as the gig worker, may be required to comply with stricter data privacy laws while collecting, handling, storing or processing information.

**Dispute resolution**

Unlike a traditional industrial dispute that may be resolved by conciliation or negotiation, any dispute arising between the platform operator, gig worker and/or customer will be governed by their respective contracts/terms of service and will be subject to consequent litigation.

**For Gig workers**

**Health and Safety**

Considering gig workers will not perform their work out of a fixed workplace, applicability of health and safety laws such as respective shops and establishment acts, sexual harassment laws may become a challenge.

**Compensation in case of accident**

The applicability of laws providing compensation to gig workers in case of accidents is yet to be tested in courts.

"Stringent confidentiality obligations regarding information belonging to platform operator and/or customers may need to be expressly enumerated."
Regulatory implications on talent marketplace model

For talent marketplace

Intermediary/payment aggregator guidelines
In India, RBI has issued intermediary or payment aggregator guidelines, applicable primarily on marketplaces who are collecting any payments from buyers on behalf of sellers. Said guidelines stipulate the opening of separate bank (nodal) account and timelines within which the amount should be credited to bank account of sellers. Similar guidelines in other jurisdictions needs to be checked.

FDI guidelines on e-commerce on service marketplace
At present, regulators have not taken a consistent position on applicability of FDI related regulations in case the platform operator is an FDI entity in India. Hence, clarity on applicability of FDI guidelines would be critical.

Transactions with platform operator in one jurisdiction and both buyer and seller in same but different jurisdiction
Where the talent marketplace is overseas, and both the other parties are in India, there could arise a likely scenario where a rupee transaction is getting routed through overseas channel involving foreign currency and the same could pose a challenge under payment and settlement guidelines and FEMA. Similar challenge can also arise in a scenario when the platform operator is in India and both the other parties are overseas.

Receipt of payment on behalf of non-resident
Collections by payment operator in India on behalf of non-resident seller could be challenge under FEMA regulations and specific RBI approval may be required.

Applicability of import and export guidelines
In case where any of the three participants are located overseas, cross border payments would tantamount to import or export of services and hence, import/export guidelines as prescribed by RBI would need to be followed. In addition, applicability of third-party payment guidelines would also need to be analysed.

Reporting mechanism
Presently, RBI does not stipulate any reporting mechanism for the export/import of services (other than ‘software’ related exports/imports). Hence, reporting mechanism in relation to such export/import of gigs may be required to be designed to regulate this model.
Should organizations in India migrate to a talent marketplace model?

Organizations can take advantage of the gig economy to drive their diversity and inclusion agenda. While such movement would bring certain challenges on one hand but alongside provides various benefits in improving operational efficiencies and reducing costs.

On demand workforce: Organisations can tap on idle hours among the talent pool by assigning them to different projects/workstreams/teams with shortage of manpower. It provides a much more effective and efficient talent pool to perform on projects and tasks.

Promoting diversity and inclusion: Companies can take advantage of the gig economy to get access to diversified and untapped talent and engage with specific talent communities for business collaboration. Such platforms also enable differently abled talent to also access job opportunities in a fair and transparent manner.

Flexibility and improved productivity: Migrating employees to a Talent marketplace model provides greater flexibility, diversified experience and continuous learning opportunities to the workers and alongside competitive advantage to the organisations.

Controlled costs: Having a talent marketplace instead of employees on payroll, can provide greater flexibility to re-allocate various costs associated with social security, labour laws, long service rewards based on the number of hours utilised.

Manage uncertain business climate: In times of business uncertainties, organisation can manage the risks of employee layoff.

Improved employee satisfaction: Given that the revenue model for gig workers is directly linked to their efforts, it would result in improved employee satisfaction and lesser resentment.

Loss of employee status: An employee migrated to a talent marketplace shall become ineligible for social benefits such as insurance, gratuity, medical benefits, provident fund etc.; and shall not have any employment-related rights provided under various labour laws.

Exposure to litigation: Unlike employees that are protected against litigation under the cover of the organisation to which they belong, a gig worker may be exposed to litigation for deficiency of services.

Novation of contracts: The organisation will have to enter into new engagement contracts setting out detailed and strict terms of engagement in lieu of existing employment agreements.

While there are challenges in implementation and regulating a gig economy, it has the potential to be the next big revolution in employment and workforce outlook. The current market situation has accelerated the need for agile organizational structures fuelled by agile talent. Therefore, large organizations, will begin their transition towards a gig economy.

The immediate step however, would be to create an internal talent marketplace within the organization, to make sure that people can be deployed and utilised more effectively and efficiently. This would definitely enable greater efficiency without the challenges and complexities of transitioning from an employment agreement to an engagement agreement.

It is however entirely up to corporations, legal specialist, lawmakers and workers’ associations to start evolving the model, to keep pace with such shifts in their talent and labor market.

Contributions from -
Senior Tax Professionals of EY: Ayush Moodgal, Kapil Manocha and Komal Grover
Nishant Arora of PDS Legal
Planning investments during COVID-19

The outbreak of COVID-19 has brought a dramatic transformation in how businesses ideate and operate. Globally, businesses have been forced to go back to the drawing board and critically examine their investment plans. All this while the global economy was already showing signs of a slowdown. The overlapping of these two events is further fueling investor anxiety. There is immense anticipation among investors about government support to industry currently. It is also becoming increasingly evident that this pandemic might have repercussions exceeding the foreseeable future. Investors now need to focus on effective planning more than ever before.

Here, we have briefly touched upon the key factors currently affecting investor mindset and decision making in India.
There has been a shift in trade and industry mindset in recent years. Companies have increasingly started identifying Asia Pacific nations as manufacturing destinations wherein China has been a favorable destination in attracting investments and has emerged as a global manufacturing hub.

There have been numerous developments in the global trade scenario. The US-China trade conflict and Make in India are some of the agendas that are considered in strategic business discussions. Due to COVID-19, many international investors with a manufacturing presence in China are facing unprecedented supply chain disruption. News reports indicate that countries hitherto heavily dependent on China may now consider other manufacturing destinations. In fact, Japan has taken a step further by announcing a US$ 2 billion stimulus package to support Japanese investments in moving out of China.

Owing to these developments, a massive geographical rejig of manufacturing hubs seems likely. Several developing nations are emerging as vying contenders. India, with its multifaceted industry initiatives may emerge as a globally preferred investment destination, if it is able to align to international standards of industrial support.

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1 reported by News18 on “India-South Korea Trade Ties to Further Improve in Post Covid-19 World With Make in India Boost” on 21 April 2020, 12:25 PM IST
Macro-economic scenario and incentives in India

Conventionally, the availability of resources and infrastructure are acknowledged as key factors for taking investment decisions. However, industry is currently experiencing an extraordinary liquidity crisis, further intensified by the currently prevailing lockdown in most countries. At such a time, any form of government support to keep operations afloat is a welcome measure. Generally, this support is extended by way of economic reforms and infrastructural support or fiscal incentives. Both have a direct positive impact on investor cash flows. Let’s take a closer look at these factors.

**Macroeconomic reforms and infrastructural support**

In India, the current situation has created additional stress on core sectors such as banking, financial services, power and telecom and also revealed some glaring deficiencies. The strength of these sectors determines the extent to which industries flourish. To further enable the industry, measures which were announced by the government in the past, need to revived. These include:

- Creation of dedicated National Investment and Manufacturing Zones (NIMZ) and focus on industrial corridors which would serve as fully enabled plug and play facilities for manufacturing activities
- Creation of dedicated Coastal Economic Zones/ Units (CEZ/CEU) and industrial corridors to enable logistical ease

The steady implementation of several such initiatives led to a jump in India’s Ease of Doing Business (EODB) ranking from 140 to 63 in October 2019. The implementation of these initiatives is likely to gain further momentum in the coming days.

**Industrial incentives in India**

The Government of India took cognizance of investor needs and launched the noteworthy Make in India initiative, which has been quite successful. Multiple incentives schemes at the central and state levels were introduced under this flagship initiative. Further, a reduced income tax rate of 15% for new manufacturing companies was introduced to bring India at par with other developing nations. These initiatives have been applauded by domestic and foreign investors alike.

Recently, some lucrative incentives schemes for electronics manufacturers were also introduced, and are generating considerable interest. Similar initiatives for other sectors are also envisaged. The pandemic has also placed the limelight on sectors such as healthcare, retail etc. Incentives are also being announced to promote these sectors. For example, the state of Tamil Nadu has introduced fiscal incentives for the manufacture of drugs and equipment employed in the management of COVID-19.

Thus, while it appears that too much is changing too fast, this may just be just the tip of the iceberg. Investor agility is now of paramount importance. Investors may lay higher emphasis on quicker returns now. Hence, infrastructure and incentives support assume even higher importance in decision making. At the same time, it is also foreseen that investors may adapt a cautious approach, leading to growth concentration in a few sectors.

The need of the hour is empathetic, pointed relief measures for industry. As a nation, India should look beyond the current methodology and rapidly enable a unified approach where the center and state collectively work to build and sustain industry. Such measures are the key and may ensure that India adapts well to the geopolitical climate of tomorrow.
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