KPMG

Supply Chain Leadership Council

TRANSPORT AND LOGISTICS

# Transporting growth to the next level

Industry recommendations related to Transportation in India

August 2010

KPMG IN INDIA

AUDIT ▪ TAX ▪ ADVISORY

# Foreword

**Manish Saigal**

Executive Director and
Head – Transportation
& Logistics
KPMG in India
msaigal@kpmg.com

Smart strides in transportation in the last decade have been key drivers of India's formidable growth story. At the same time, the lack of adequate infrastructure, seamlessness and operational inefficiencies are some of the many caveats that accompany this great story. It is abundantly clear and admired that many measures have been taken by the Indian government to make this sector competitive and growth orientated. The positive effects of these steps are becoming evident with the quadrupling of India's port capacity, additions to cargo rail infrastructure and services and global shipping connectivity. It is, however, also evident that many more measures will need to be taken to make India a competitive and efficient transportation-driven economy. The transportation sector could benefit greatly, in efficiency as well as growth, with an integrated approach to policy making and corresponding private investment.

We, at KPMG in India, have had the opportunity of working closely with several transportation and infrastructure companies across the sector and multiple policymaking bodies, placing us in the midst of events shaping up this industry. In addition, our experience with manufacturers and traders in India has given us a hands-on understanding of the operational issues faced by both service users as well as the service providers of this sector. We are glad that we could use this experience and mobilize that of the senior most representatives of the industry towards the development of this paper. This paper examines policy, operational and fiscal issues faced by stakeholders across the industry, and collates their recommendations with corresponding rationale. The intention of this paper is to contribute positively to the policy and legislative infrastructure that governs the evolution of this important and exciting industry.

# Foreword

**Gautami Seksaria**

Founder & Partner
Supply Chain Leadership Council
gautami@sclc.in
www.sclc.in

The last decade has been one of the most exciting for the Indian maritime transportation industry across its components - deep sea shipping, rail, road, coastal shipping and ports. As the industry made a habit of double digit growth throughout most of the last decade, it has had a tough run in the recent past led by a global trade slowdown. As signs of a firm revival appear on the horizon, the Indian transportation industry, its stakeholders and its custodians have the clear and present opportunity, based on the learning from the past, to create a firm and sensible platform for growth in the coming decade.

This paper represents the wider industry's wish list towards the policymakers. We are grateful to KPMG for mobilizing the suggestions and recommendations contained in this paper from across the industry and its multiple facets making this paper as being for the industry, of the industry and by the industry. We also wish to put on record our admiration for the wisdom provided by Indian National Shipowners' Association towards the construction of this paper. We would like to express our gratitude to the several organizations who actively participated in the development of this paper but especially Gateway Terminals India, Maersk Line, APM Terminals Pipavav, Indira Container Terminal, Admec Logistics and Indian Private Ports and Terminals Association.

This paper well represents the very purpose and the DNA of the Supply Chain Leadership Council. The Supply Chain Leadership Council is dedicated to be the playground as well as the platform of the Indian transportation and logistics community. In its role as the playground, the Supply Chain Leadership Council will create quality and frequent interaction opportunities between the members of this community – cargo owners, service providers, infrastructure creators and policymakers. In its role as the platform, the Supply Chain Leadership Council will crystallize the opinions, discussions and wishes of the Indian transportation and logistics industry to the attention of the policymakers and industry groups. Accordingly, we are glad to have provided the platform of India Container Logistics Summit 2010 for the release of this paper.

# Foreword

**Anil Devli**

Chief Executive Officer
Indian National
Shipowners' Association
ceo@insa.org.in

Shipping is the lifeline of a growing economy like India blessed with an extensive coastline with more than 14,000 kms of inland waterways. Approximately, 95 percent of the country's trade by volume (68 percent in terms of value) moves through sea. Clarkson's Research Service reports that India currently ranks 22nd in terms of growth of world tonnage when compared to the principal maritime countries of the world. Moreover, shipping is also an important earner of foreign exchange. According to a study conducted by the National Council of Applied Economic Research (NCAER), shipping as a single industry is one of the largest contributors to the foreign exchange pool of the country. The Indian shipping industry plays a vital role in the energy and national security of the country. The issue of energy security is of paramount importance considering the fact that India is greatly dependent on the import of energy resources such as coal, crude oil and natural gas.

In addition to the earning and saving of foreign exchange, a major proportion of revenue of Indian shipping Industry is utilized to build national assets or fund domestic expenditure. A growing shipping industry helps in generating employment opportunities in the country as well creating a large pool of skilled personnel connected with the maritime industry. It is also pertinent to note that shipping is not a stand-alone industry and has collateral linkages with several other maritime industrial activities of considerable economic consequence. However, the shipping industry faces a number of issues and challenges that need to be addressed. Furthermore, tax benefits available to the infrastructure sectors are not extended to the Indian shipping Industry. This paper provides an overview of the issues related to the Indian Maritime sector and elaborates the opportunities and challenges faced by the sector. It is our hope you find this paper informative and useful.

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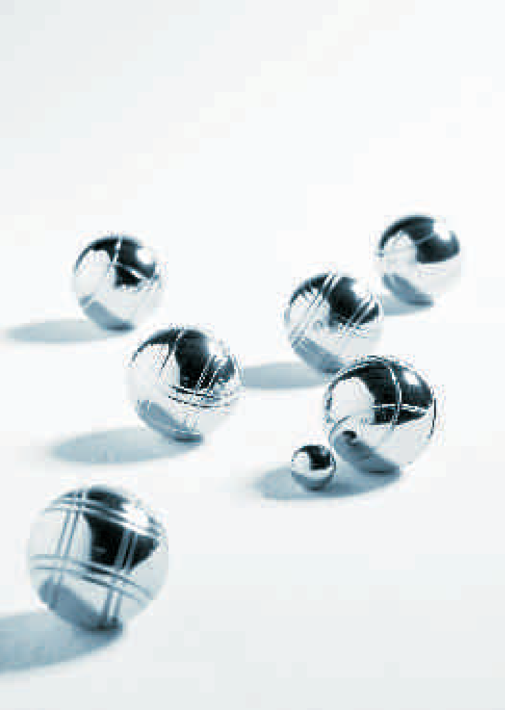

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# Introduction

The high growth trend in Indian GDP is reflected in the country's burgeoning international trade and the consequent high growth in traffic volumes for the shipping and ports sector over the past few years. High Export-Import (EXIM) growth is not limited to India. Trade volumes in entire South Asia and South East Asia have grown at a higher rate than the global average due to the growth in Asian economies, principally China and India. This would, in turn, translate into additional demand pressures on the Indian transportation sector and its main components – shipping, ports, rail and multimodal and coastal shipping. Overall, the Indian maritime sector is poised for healthy growth complementing the growth of the Indian economy. This requires interest and investments by multiple stakeholders, including the government, the public and the private sector. Moreover, there is need for urgency towards improving the physical and the legislative infrastructure related to this sector thereby creating an environment conducive for optimal growth and development.

## Shipping

Shipping is a cyclical and capital intensive business, fortunes of which are significantly affected by an interplay of factors such global trade demand on the one hand and vessel order delivery on the other. The shipping sector has witnessed significant cyclicality in the last decade with a surge in freight demand in the middle of the decade slowing down dramatically owing to a global recession towards the end. With the sector completely open to foreign investment, there have been significant improvements in shipping capacity available to Indian manufacturers and traders as well as operational and scale efficiencies. Today, India is firmly placed within the global liner network connecting Indian importers and exporters to the remotest parts of the world. The average capacity and parcel size of a vessel calling Indian ports has trebled since the beginning of the decade and there have been significant improvements in turn around time and similar measures of operational efficiency. There has been significant investment made in the sector both by Indian shipping companies and International organizations alike. Challenges, however, remain both on the physical and operational front as well as on the policy front. Indian shipping is not able to achieve its full potential restricted by limited draft availability in most ports, sub-optimal distribution of port capacity across the coastline, limited road and rail evacuation capabilities and restrictive legislative infrastructure in terms of tax and other policies. The paper discusses these challenges in greater detail in subsequent sections.

## Ports

The ports sector in India has had a brilliant run in the last decade witnessing significant additions in capacity across the Indian coastline and cargo types. This has been possible on the back of an excellent public-private program executed by the Government of India in the ports sector attracting significant investments from Indian as well as overseas port operators and investors. Current trade growth trends suggest that the Indian ports sector would continue to require significant additions to capacity to meet future cargo handling demand across cargo types but especially on the container side. Unfortunately however, there has been a marked slowdown in the award and execution of port projects. Indian ports tend to be congested affecting optimal operation. Besides and often, capacity on the water side is limited by capacity on the yard or gate side as well as the evacuation support available to the port. Indian ports face significant hinterland connectivity pressures often limiting overall available capacity to the capacity of the rail/road linkages. Several other challenges and recommendations related to ports in India are available in this document.

## Coastal Shipping and inland waterways

India's 7,500 kms coastline and over 14,000 kms of navigable waterways make it an ideal geography to effect transportation by coastal shipping and inland waterways movement. Coastal shipping and inland waterways are two modes that are cost-efficient and environment friendly but are currently rendered unattractive due to a relatively restrictive policy regime and market dynamics. Coastal shipping requires very simple infrastructure, unlike the ocean going vessels, with provision for smooth transfer of cargo between coastal ships and ocean going ships. Most major ports are ill equipped as far as providing infrastructure to coastal shipping vessels is concerned. Ocean going vessels and coastal shipping vessels are treated on par and ports do not differentiate them in terms of port charges which are not conducive to the incubation of an industry in its infancy. These and other challenges have been further deliberated upon in the Coastal Shipping section of this paper.

## Rail and multi-modal transportation

India will need to focus on multi-modal transportation to facilitate movement of goods from inland locations to ports and vice-versa. This would require development more and better road and rail infrastructure, improvement in multi-modal connectivity and modifications in procedural arrangements to allow smooth flow of traffic over multiple modes. The Government's decision to allow private participation in container transportation by rail is a welcome move and private investors and operators have responded with enthusiasm. However, the Government will have to develop a legislative infrastructure and promote development of greater physical infrastructure to allow these private players to gain reasonable scale. Challenges related to this sector are included in the Container Rail section of this paper.

# RECOMMENDATIONS FOR

# International Shipping Sector

## Policy

### Reduce the cost of Indian Flag

#### Current status

While shipping is a global industry, cost of Indian flag is very high compared to international shipping hubs owing to high direct and indirect taxation leading to higher costs to end user/charterer choosing Indian flag vessels

#### Recommendation

The cost of Indian flag should be brought at par with those of the developed maritime nations such as Singapore. Freight rates to be moderated, possibly by cargo arrangements made through Transchart

#### Rationale

This will balance the objectives of maximizing cargo transported under the Indian flag vis-à-vis globally competitive freight rates to the end-user. It may be observed that the high cost of Indian flag vessels is due to the current taxation regime of high direct and indirect taxation. Despite the introduction of Tonnage Tax in India (which brought in alternative lower taxation rate in lieu of Corporate tax), there are around 10 other direct and indirect taxes that translate into a substantial disadvantage to Indian shipping companies vis-à-vis their foreign counterparts please. This obviously affects the competitiveness of Indian shipping companies, and in turn, their ability to invest for growth and diversification of their fleets. Hence, it is imperative that required changes in the taxation policy i.e. exemptions / reductions of various direct / indirect taxes as relevant be considered favorably on a priority basis.

### Infrastructure status for Indian shipping

#### Current status

Tax benefits available to the infrastructure sectors are not available for the Indian shipping industry

#### Recommendation

Extend 'Infrastructure' status to Indian shipping industry

#### Rationale

Shipping is capital intensive business and subject to extreme business cycles. Infrastructure status would enable cheaper loans as well as improved gearing (debt:equity ratio) to ship owners such that they are able to sustain the high capital investment in periods of downturn .

# Fiscal

## Exemption from service tax

### Current status

Service tax is levied on various services availed by the shipping companies including some on reverse charge basis

### Recommendation

Exemption from Service Tax on some 27 major services including ship management, manpower recruitment, brokerage etc as well as some on reverse charge basis availed by the shipping companies so as to remain competitive

### Rationale

Globally, input services for shipping industry are not subject to service tax, whether such services are availed domestically or internationally.

## Tonnage tax: MAT on profits on sale of ships

### Current status

The book profit on sale of qualifying ship (which reflects the present value of the profits likely to be generated over the balance economic life of the ship) is currently not covered as relevant shipping income under subSec.115VI (1) (i). Also as per Sec115VN, any profits or gains from transfer of qualifying/capital assets are chargeable to income tax under Sec.45 to 51 of the IT. Act. Due to the 'block of assets' concept though this may not be affecting the tax computation under normal circumstances, it affects tax computations for the purposes of MAT under Sec.115JB of LT Act since the profit on sale of ship will form part of 'book profit'

### Recommendation

Book profit on sale of qualifying vessels should not be subjected to MAT but may be treated as arising from core activities of a tonnage tax company.

Hence it may be covered under Sec. 115VI by adding a new sub-clause to sub-section (2) as under: “(iii) surplus or deficit on sale of qualifying ships”

### Rationale

Sale/purchase of ships are intrinsic to the industry's core business – i.e. to meet the changing global trading pattern, to comply with international maritime laws and to ensure economic viability due to technological advancement. Based on this, major maritime nations like UK, Ireland, Singapore, and Netherlands have covered profit on sale of vessels in their TT regime. Profit on sale of ship on forming part of relevant shipping income would attract provisions of Sec.115VT(1), viz. compulsory transfer of profit to TT reserves, thus leading to a further growth in tonnage.

## Tonnage tax: Interest earned on TT reserve

### Current status

Interest earned on TT reserve is treated as pure income and currently taxed at the corporate income tax rate

### Recommendation

Interest earned on TT reserve needs to be treated as income from core activities. In Section 115VI after sub-section (2)(B), the following may be inserted: '(C) interest earned on funds deployed out of unutilized amounts standing to the credit of statutory reserves created under Sec.115VT at the beginning of the relevant previous year'

### Rationale

The Indian TT scheme has the unique feature of compulsory creation of Reserves to be utilized only for tonnage acquisition. While waiting for opportune time to acquire the assets, the interest generated needs to be treated as core income which would further attract provisions of Sec.115VT(1) viz. compulsory transfer to tonnage tax reserve for buying ships. Moreover, DTAs with countries like Belgium, China, Denmark, Germany, Netherlands, Malta, S. Africa, UAE, US, etc. have treated interest on funds as income from shipping operations.

## Seafarers Taxation: Shortage of manpower

### Current status

Indian ships face acute shortage of trained/qualified and experienced manpower, especially officers' category, because of drift of personnel from Indian flag ships to foreign flag under lure of 'tax-free' pay packet arising out of certain unintended differential domestic tax treatment. Presently, there are around 40,000 Indian Officers in the Nautical and Engineering categories and 80,000 Indian crew in the ratings category working on both Indian and foreign ships, with about 75 percent of them serving on foreign ships. A recent BIMCO/ISF study has predicted a global shortage of 25,000 qualified and experienced seafarers in the officer and engineer categories by 2015

### Recommendation

Proposal – 1: Income generated by seafarers on board Indian vessels whether operating on Indian coast or international waters may be treated as tax free.

Proposal – 2: Since the above measure would require legislative amendment, in the interim period MoF may issue clarificatory circular to supersede the CBDT circular 586 of 28-11-1990 by counting the seafarers stay out of the country on the basis of dates stamped on his/her passport/CDC

### Rationale

Such a measure will help minimize 'attraction' on foreign flag which will help improve the manpower availability situation in the country for Indian shipping.

## Direct tax: Withholding tax on ECB interest

### Current status

Interest paid to foreign lenders is subject to withholding tax at the rate of 20 percent which may be reduced to 10-15 percent as provided in respect DTAAs

### Recommendation

Restore exemption u/s.10(15)(iv) of I.T. Act

### Rationale

Shipping is a global industry and purchase of ships is financed with significantly high gearings. Since 75 to 80 percent of the funding for ship acquisitions is through foreign lending, withholding tax on interest payouts to foreign lenders by Indian borrowers increases the cost of borrowings.

## Indirect tax: Customs duty on repair material

### Current status

Exemption from Customs Duty on direct import of repair materials by shipping companies for repairs in India

### Recommendation

As in the case of ship repair units, shipowners may be permitted to import spares and repair equipment directly for carrying out repairs in India without being subject to payment of customs duty

### Rationale

Treatment of shipping companies and ship repair units should be at par in context of purchase of imported spares and repair equipment for ship-repair purposes.

## Service tax: Input services

### Current status

Service tax is currently imposed not only on various services availed by the Indian shipping companies domestically but also on some of the crucial services availed by them, even outside the country. Although with the introduction of the Taxation of Services (provided from outside India and received in India) Rules, 2006, certain services received by shipping companies outside India are exempted, there are still few services including some on reverse charge basis on which Indian shipping companies suffer tax

### Recommendation

Service tax on the following input services should be zero rated for the shipping companies. (i) Brokerage, Commission and Finance charges (ii) General Insurance Services including P&I insurance (iii) Ship Management Services; and (iv) Manpower Recruitment and Supply Agency Services

### Rationale

Globally, (esp. in major maritime jurisdictions like UK, Singapore, Netherlands, Greece etc.), taxes relating to the shipping industry are either zero rated/exempted, whether such services are availed domestically or internationally by non-resident or resident ship-owner. The Government has, by introduction of Tonnage Tax, recognized the need to create tax parity with other shipping jurisdictions to create competitiveness in this industry. It is essential that this philosophy is also extended to create a comprehensive zero rating of indirect taxes for the industry.

## Access to competitive funding

### Current status

The working group of the Eleventh Plan in its 3rd scenario has placed an expansion target of 15 million GT to be achieved by the end of the Plan for the Indian shipping industry. As estimated by a SBI Capital Markets report, it presently entails a cost of Rs.38,100 crores for acquiring additional tonnage of approximately 9.72 million GT after taking into account the scrapping of 4 million GT due to old age/IMO phase out regulations. Being a very capital-intensive industry, shipping depends heavily on long-term debt to fund its capital investments, and therefore the requirement for debt to fund the above expansion is very large. Since there is no established ship finance institution in India, Indian shipping companies have tended to source funds from international lenders. However, the meltdown in global financial markets in 2008 has severely constrained the availability of credit from international banks to provide long-term funding to capital intensive assets like ships

### Recommendation

The Government could establish a Shipping Modernisation Scheme, in line with the recommendation in the SBI Capital Market's report, on the lines of the Technology Upgradation Fund Scheme (TUFS) for the textile industry.. The details of the scheme are as follows:1) Loans provided by Indian banks or other agencies will be eligible for interest subvention 2) Interest subvention would be available on a total loan amount of upto Rs. 26,670 crores, used for acquisition of shipping assets 3) The interest subvention would be at 5 percent p.a. of the loan amount, for upto 10 years from the full drawdown of the loan 4) It is expected that tax inflows from the additional acquisitions would compensate for the interest subvention provided, and that the scheme would have a positive Net Present Value (NPV) for the Government

### Rationale

This scheme will help in ensuring the targeted expansion in the Indian shipping industry through the availability of credit to Indian shipping at a reasonable cost.

RECOMMENDATIONS FOR

# Ports Sector

## Policy

### Corporatization of Ports

Current status

Most of the major ports operating in India are not corporatized and are administered by trusts under Major Port Trusts Act (MTPA) 1963

Recommendation

Corporatization of all the major ports

Rationale

MPTA has many outdated provisions that inflate port charges. This has resulted in foreign ports taking away traffic from our major ports and prevented them from functioning in an agile manner. A corporate tag would accord them the autonomy required for improving efficiency of operations as well as decision making.

### Unavailability of adequate land to set-up CFS

Current status

Unavailability of adequate land for development of container freight stations is leading to a crunch in available CFS capacity as well as causing CFSs to be pushed further away from the port gate causing compexities in operation and an escalation in cost

Recommendation

Government to facilitate provision of land to catalyse the development of sufficient CFS capacity in reasonable proximity to ports

Rationale

Lack of CFS capacity tends to cause congestion within port operations and leads to operational and cost inefficiencies for exporters and importers.

## Improvement in hinterland connectivity and last mile infrastructure

### Current status

The transit time of container trains have to improve and the railways need to accord due priority to timely movement of these trains. It happens many a times that the goods wagons are held up at places to allow movement of passenger trains. Such instances lead to high transit times and at times the container misses out on the vessel which has a fixed window at the port. Besides, low quality infrastructure towards the last mile tends to become the weakest link in the transportation chain making the entire supply chain fragile

### Recommendation

Priority movement of container trains and movement as per schedule. These may be incorporated as contractually binding obligations and damages may be prescribed for either party if there are delays on account of the rail operators or IR, as the case may be. Besides, there is an urgent need to invest or promote investment in the development of last mile infrastructure

### Rationale

Seamless and fast movement of cargo between the port and hinterland would improve the productivity of the ports substantially and help in decongesting port facilities. Besides, good last mile connectivity will ensure an equitable distribution of flow of traffic across ports in India instead of a handful of ports.

## Reduce vessel related charges in major ports

### Current status

Vessel related charges for berth hire and pilotage charges are quite uncompetitive as compared to alternative foreign ports

### Recommendation

Vessel related charges shall be reduced to make the overall call for a ship cost competitive when compared to alternate ports

### Rationale

High vessel related charges leads to loss of potential vessel calls in key Indian ports to alternative foreign ports while adding to the overall cost of shipment for the cargo owners.

## Introduce certainty in development of supporting infrastructure

### Current status

BOT projects are being awarded to private operators across the country based on, in many cases, the understanding that critical infrastructure such road/rail connectivity, dredging and land for truck parking areas etc will be developed alongside the development of the terminal by private operators. However, such infrastructure projects are not always implemented in a timely manner

### Recommendation

Development of critical infrastructure to support the operation of terminals concessioned to private terminal operators be either expedited or included, where possible, within the scope of the concession with reasonable adjustments in the lease/royalty payments from the operator to the government.

### Rationale

Lack of such infrastructure, critical to the successful implementation and operation of private terminals in ports, affects operations on the one hand while keeps away potential investors.

## Deepening of JNPT channel

### Current status

In spite of being India's premier gateway port handling close to 50 percent of its container trade, the draft available in the JNPT/Mumbai channel is insufficient for larger vessels to call

### Recommendation

Expedite deepening of JNPT/Mumbai harbor channel

### Rationale

Given an increase in average parcel sizes per vessel call, shipping lines would like to deploy larger vessels on routes where JNPT is a call thereby increasing capacities available to Indian exporters and importers. However, due to restricted draft, average size of vessels calling JNPT remain a third of the vessels calling most other large ports globally, including in emerging economies.

### Widening and maintenance of approach and service roads around ports

#### Current status

There are severe inadequacies in road infrastructure around key ports of the country creating operational complexities for the port, operators as well as traders adding to congestion in and around port facilities

#### Recommendation

The approach and services roads in the port area need to be widened and well maintained, while the service roads to the back up yards and related facilities need to be developed and maintained. There is also a need to identify and develop key rail-road interaction nodes to facilitate inter-modal movements and inject seamlessness in container transportation

#### Rationale

Requested developments will resolve operational issues and congestion in and around the ports but in the entire container logistics chain.

## Fiscal

### High cost of capital for port developer

#### Current status

Interest income to lenders of port projects is taxed and so are long term capital gains and dividends, in turn leading to high cost of capital for a port developer

#### Recommendation

Interest income to lenders of port projects may not be taxed and tax exemption on long term capital gains and dividends arising out of investments in port companies may be restored. This can be done by restoring section 10(23G) of the Income Tax Act and making it applicable to ports developers

#### Rationale

Since the port projects, unlike some other projects face market risks, coupled with lumpiness of investments, it is important to facilitate a lower cost of capital for port developers.

## Excise duty set off on port construction

### Current status

As per the CENVAT rules, excise duty paid on plant and machinery can be offset against service tax collected / excise duty collected for service rendered / product sold. It is difficult to avail benefit from this offset in port construction because the bulk of the investment is in berths, warehouse, tanks, etc. and the plant and machinery is limited to cranes / mobile equipment

### Recommendation

Investment in berths, warehouse, tanks, etc. should be explicitly clarified as plant and machinery as per CENVAT rules

### Rationale

This will allow ports to obtain CENVAT credit easily against excise duty paid on cement and steel.

## Income tax benefit not available to port-related support infrastructure

### Current status

While ports are allowed income tax exemption under section 80 IA, the relevant provision in Income Tax Act limits the exemption to only those infrastructure facilities which have entered into agreement with the government, local bodies, statutory bodies, etc. Further, presently, the definition of 'infrastructure facility' does not expressly cover Container Freight Stations (CFS), inland container depots (ICD), etc. and, hence, there is difficulty in claiming 80-IA on such infrastructure facilities

### Recommendation

A provision can be made in Income Tax Act to grant section 80 IA benefits to such players who have developed the facilities on land leased from the port (private or government) and to the extent they handle cargo emanating / terminating at that port. Further, the definition of 'infrastructure facility' should be amended to include CFS and ICDs

### Rationale

Benefits to a port should also extend to the players who are port-based infrastructure service providers since their presence is critical for development of port itself. This includes independent CFS in the vicinity of ports, ICD, independent warehouse service providers and tank terminal operators, inter alia.

## Ports serving SEZs as well do not get equivalent tax incentives

### Current status

While ports are allowed income tax benefits under section 80- IA, they are not exempt from MAT provisions, even though such an exemption is available to SEZ developers entitled to section 80-IAB benefits

### Recommendation

Ports which are part of SEZ but do not handle exclusively SEZ cargo should also be granted to MAT exemption

### Rationale

It is not practical to develop a common user facility for SEZ cargo only. Even though both, port and SEZ, are infrastructure meant for enabling EXIM trade, and have similar investment and market risk profile, still, ports have to pay Minimum Alternate Tax (MAT), while SEZ developers do not have to pay MAT. Such MAT exemption to ports will also encourage ports to establish linkages with many SEZs, thus improving the viability of SEZs as well.

# RECOMMENDATIONS FOR

# Coastal Shipping Sector

## Address issue of high tariffs

### Current status

High port tariffs apply to coastal shipping which is a threat to the development of this new industry. Besides, limited availability of berthing for coastal ships at most ports limits the operational viability of running services

### Recommendation

Wharfage on coastal should be reduced to 10 percent of the wharfage cost charged to EXIM cargo. Also, wharfage on the same cargo should not be charged twice (once at the load port and once at the disport). Besides, there should be a special tariff for coastal cargo at minor ports, as there exists at major ports. In addition, minor ports and terminal operators to be issued guidelines that they shall accord priority the same priority to coastal cargo as they do to EXIM cargo. Overall, this should work as an Incubator scheme for a fixed period of five years which can help incubate coastal shipping projects

### Rationale

Coastal shipping is an industry in its infancy multiple advantages. These changes will encourage investment in the sector allowing it to incubate successfully and integrate itself as an additional, cost effective and environmentally sensible mode of transportation within India's overall transportation system.

## Address the issue of service tax

### Current status

Ships or cargo interests pay service tax at each and every port for the same cargo. For example if Container 'A' moves from Mumbai to Goa, then service tax is liable on each and every port charge applied for loading in Mumbai as well as discharge in Goa

### Recommendation

The service tax for coastal ships should be completely exempted, if not, only nominal tax should be paid on yearly basis for vessels involved in coastal services

### Rationale

Globally, shipping is kept out of the purview of local taxes, GST, etc. Examples of this are Australia, Singapore and UK where shipping is not liable for GST. Besides, input services for shipping industry are not subject to service tax globally. These services include brokerage, commission and finance charges, general insurance services including P&I insurance, ship management services, and manpower recruitment and supply of agency services

## Indirect tax: Customs duty on bunkers and repair materials by shipping companies for repair in India

### Current status

- High duties on bunkers in India vis-à-vis bunkers in key international markets makes bunker cost in India between 40 percent and 80 percent is being borne by the coastal vessels
- Presently spares and equipments imported by ship repair units registered with the Directorate General of Shipping operating at various ports in the country for repair of ships are exempted from customs duty. Ship-owners are not permitted to import spares directly.

### Recommendation

- There should be no customs duty/other levies on bunkers consumed by coastal ships
- As in the case of ship repair units, shipowners may be permitted to import spares and repair equipment directly for carrying out repairs in India without being subject to the payment of customs duty.

### Rationale

- Bunkers form a substantial component of the direct operating cost of a vessel constituting about 34 percent. A sensitivity change of 20 percent in the costs bunkers would result in a change of 7 percent of the operating costs of a vessel) In fact, high bunker costs and the non-availability of bonded bunkers at Indian ports have been identified as one of the serious stumbling blocks in the development of coastal shipping
- Purchase of ship repair equipments through ship repair units at inflated cost adds to the repair costs in India, which are already higher than in foreign yards. In addition, transfer of spares by the ship repair unit to the shipping company attracts taxes which when added to the service fee charged by the ship repair units, results in a substantial burden for coastal ship owners and operators

## Other related issues for development of Coastal Shipping

- Introduce a Modal shift programme initiative on the lines of the European Union's 'Marco Polo' Programme comprising the two components: (a) Modal Shift action and (b) Catalyst action, Contours of such Programme could be worked out by consensus in the 'Working Group on Shipping and IWT'
- Complement above initiative by (i) Central Government to consider diverting its own / its agencies' cargo to Coastal Shipping, (ii) Due to non-availability of cargo for return voyages, extend appropriate incentives to trade (Multimodal Transport Operators and shippers etc.) for adopting coastal shipping mode for sizeable domestic cargoes in preference to rail / road mode. Deduction from taxable income-based on traffic diverted by shippers may be pursued
- Coastal shipping is the most environmentally friendly mode of transportation and with the growth expected in India's cargo generation – both domestic and EXIM, its greater and optimal use will be increasingly essential, especially from the point of view of gaining carbon credits. Therefore, it should be accorded its due importance and a special body within the Ministry of Shipping should be formed to facilitate and encourage its development.

RECOMMENDATIONS FOR

# Container Rail Services Sector

## Policy

### Lack of common user ICDs / DCTs to support train operations

#### Current status

Although the Government has taken positive steps to allow private players in container rail terminal operations, but the requisite support infrastructure in terms of common Inland Container Depots (ICDs) or Domestic Container Terminals (DCTs) is lacking. Additionally, it is also difficult to procure the land to construct ICDs / DCTs and the available unused railway sidings are entangled in bureaucratic complexities

#### Recommendation

The Government should itself or under PPP model set-up a network of common user rail integrated terminals (ICDs / DTCs). In addition to that, Government should also speed up the allocation of unused railway sidings to private players, so as to enable them to have a level playing field with state run services

#### Rationale

This move will enable healthy competition with trade efficiencies and can also lead to further shifts in movement of trade from road to rail.

### Development of rail integrated Mega Logistics Parks

#### Current status

Few modern, common-user, integrated and multi-modal logistics facilities exist causing cargo to remain fragmented over several modes, locations and sub-scale facilities not allowing container logistics to flourish to its full potential towards the mutual benefit of service users as well as service providers

#### Recommendation

Indian Railways, through the Government of India, should take an initiative to develop rail integrated mega logistics parks in key locations in India based on the PPP model

#### Rationale

Central development of such mega logistics parks will have multiple benefits including the following

a. It will save Infructuous movement of IR Locomotives after terminating the journey at destination as in mega logistics parks, the same power can be used to haul other trains in waiting

b. It will solve the problem of increase in project costs due to delay in land acquisitions by container train operators independently

c. Rail share can only be increased by having aggregation / segrregation of cargo, by providing additional value added services like packaging, warehousing, cold storages, etc. for which significant land is needed

d. Maintenance like ROH/POH is possible only in mega logistics parks thereby increasing the productivity of rolling stock.

## Fiscal

### Haulage charges of container trains

#### Current status

Haulage charges for container trains are very high. Most of the freight trains connect one port or the other, so it is the port traffic which bears the maximum burden of high haulage charges. If the trains have to compete with road transport, it has to offer its services economically, which means haulage charges have to be scaled down to competitive levels

#### Recommendation

Reduction in haulage charges. In addition, there may be a prescribed upper limit on the extent of revision in haulage charges over and above the number of revisions that are already a part of the rail concession, to protect against discretionary increases

#### Rationale

Reduction in haulage charges is likely to contribute to increase in competitiveness of rail haulage vis-à-vis road.

### Removal of service tax for goods moved in containers on rail

#### Current status

Service tax is currently applied to carriage of goods in containers on rail

#### Recommendation

Removal of this service tax application in line with similar exemption granted to goods moved on rail through other than in containers in 2009

#### Rationale

The application of service tax on top of already high haulage charges has made carriage of goods in containers on rail a difficult choice for traders as well as domestic distributors slowing down the pace of shift from road to rail.

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## KPMG in India


### Bangalore
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

### Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

### Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

### Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

### Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

### Kochi
4/F, Palal Towers
M. G. Road, Ravipuram,
Kochi 682 016
Tel: +91 484 302 7000
Fax: +91 484 302 7001

### Kolkata
Infinity Benchmark, Plot No. G-1
10th Floor, Block – EP & GP, Sector V
Salt Lake City, Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

### Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

### Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775


## Key contacts


### Vikram Utamsingh
Executive Director and
Head of Markets
Tel: +91 22 3090 2320
e-Mail: vutamsingh@kpmg.com

### Manish Saigal
Executive Director and Head
Transportation & Logistics
Tel: +91 22 3090 2410
e-Mail: msaigal@kpmg.com

### Gagan Seksaria
Associate Director
Transportation & Logistics
Tel: +91 22 3090 2602
e-Mail: gagan@kpmg.com