

Aerospace – Indian Regulatory & Policy Environment

Being a sector of strategic importance, the Indian government has played an important role in the development of aerospace sector. The sector was highly regulated and controlled by the state until last decade.

Investment measures

The Government encourages private investment in both the civil and defence aerospace sector with the goal of encouraging technology transfers and achieving indigenization. Over the last decade, there has been substantial liberalisation in the civil aviation sector; domestic private players are now allowed in aerospace manufacturing & R&D and 100% FDI is allowed under automatic route for most of the activities. The investment limits for domestic and foreign private participation in various aerospace activities are as below:

- Manufacturing and R&D activity is allowed 100% FDI on automatic route in all areas, except air traffic services.
- In defence sector, 100% domestic private investment is allowed but only 26% FDI is permitted in the manufacture of defence equipment, which is also subject to licensing requirements.
- 100% FDI permitted under automatic route for MRO, flying training institutes and technical training institutes.
- 100% FDI under the automatic route is permitted in setting up of Greenfield airport projects
- FDI up to 49% is permitted for scheduled air transport services/domestic scheduled passenger airlines under the automatic route. NRI investment is permitted up to 100% under the automatic route. However, no direct or indirect equity participation by foreign airlines is allowed.
- For non-scheduled air transport services/non-scheduled airlines, chartered airlines and cargo airlines, FDI up to 74% is permitted under the automatic route. NRI investment is permitted up to 100% under the automatic route.
- FDI up to 74% and NRI investment up to 100% under the automatic route is permitted for ground handling services subject to regulations in the sector and security clearances.
- FDI up to 100% is permitted under the automatic route for helicopter services / sea plane services requiring DGCA approval.

A significant initiative of the government has been the introduction of defence offset policy with effect from 2008, which mandates foreign aircraft OEMs to outsource a minimum of 30% of defence procurement to Indian companies, in the areas of infrastructure, technology sharing, components or services. Players like Air India have for instance entered into an agreement with Boeing with a 50% offset obligation. Such policies have provided an opportunity for Indian manufacturers to enter the aerospace manufacturing and gain expertise in high tech industry with its stringent requirements for safety, quality control and precision.

Taxation and subsidies

The government provides various tax incentives to the domestic and foreign manufacturers for R&D activities and for establishments in the Special Economic Zones, as provided in the table below.

Type of Incentive	Details
Deductions from Income tax	Accelerated depreciation of 40% is available for airplanes & aero-engines
Tax exemptions/ Tax holidays	100% tax exemption for airport projects for a period of 10 years
R&D related tax deduction	If certain conditions are met, deduction is available of one and one half times of scientific research expenditure incurred by a company on in-house R&D facility
Royalty/ fee waiver	Royalty/fees for technical services received by a foreign company under an agreement with Government for providing services in or outside India in projects connected with the security of India, is exempt, if such foreign company is notified by Central Government in the Official Gazette
Exemption from withholding tax	Exemption from payment of withholding tax on lease rental incomes on aircrafts and engines earned by a non-resident lessor from an Indian company with respect to lease agreements which have been signed prior to 31 March 2007

The tax incentives provided to the manufacturers in the aerospace segment are not adequate to provide a relief against the multiple levels of taxes levied, that often renders the sector uncompetitive. For instance, aircraft servicing activities in India are subjected to variety of levies such as customs duties, service tax and VAT. Further, domestic manufacturers supplying to the defence sector are often disadvantaged against foreign vendors as the latter often enjoys various tax and duty exemptions for its supplies from abroad to the Ministry of Defence. Imports by MoD from foreign vendors do not attract customs duty and other levies like excise duty, sales tax and VAT are not applicable to imported products. Further services availed by foreign vendor from India are exempt as these are treated as export services. In contrast, domestic suppliers are subject to various duties like excise duty, CST, and VAT. Additionally, service tax is applicable on input services like payment on Technical knowhow/ engineering services.

Focus on Research & Development

There are numerous government research institutes and organisations in India that carry out intensive research and development for the aerospace sector, namely Hindustan Aeronautics Limited (HAL), Defence Research and Development Organisation (DRDO), National Aerospace Laboratories (NAL), ISRO, etc. However, the progress on R&D front has been relatively slow. Recognising the future needs of the defence sector, the government has invited private sector participation from domestic as well as foreign players in research and development activities, providing 80% funding to the projects. Global players are also attracted to set up captive R&D units in India on account of low cost talent pool of engineers and scientists. Some of the major foreign players with R&D operations in India include Airbus, Snecma and Boeing.

Efforts of State Governments

State Governments have also taken several initiatives for the development of Indian aerospace sector. The Tamil Nadu Government plans to establish an aero park for global aerospace and aeronautics industry in the areas of design, manufacture and maintenance of aircrafts. The park will be similar to those in Dubai, China and Singapore. Similarly, the Andhra Pradesh Government has plans for two aerospace and precision engineering Special Economic Zones (SEZs) in the state.