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Tax Alert – Key announcements of Union Budget 2025

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Government continues modernization efforts and enhancement of indigenisation in Defense sector

Impetus to Industry for R&D efforts through increased allocation for Make projects

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The Finance Minister of India presented the Union Budget 2025 on 01 Feb 2025, allocating INR6,81,210 crore (~US$ 78.57 billion) to the Ministry of Defense, which is ~13.44% of the total budget and ~1.9% of the GDP.

While capital outlay witnessed an increase of 4.65%, allocation for revenue expenditure was increased by 10.24% over FY 2024-25 (BE) for operational readiness of the armed forces. Support for Agnipath scheme has seen a steep increase by ~84% for FY 2024-25 (BE).

The budget allocation indicated continued focus on indigenous research & development (R&D) and joint procurement of major defense platforms such as aircraft and aeroengines. The allocation towards capital R&D is INR14,924 crore (~US$ 1.72 billion), which is ~13% higher than FY 2024-25 (BE). Further, assistance for prototype development under Make procedure witnessed a ~13.27% increase over FY 2024-25(BE).

Continuing the momentum of ongoing and future reforms, 2025 has been named as the 'Year of Reform' by the Indian Ministry of Defense signalling strong focus on Joint & Integration initiatives amongst the Armed Forces, establishment of the Integrated Theatre Commands and focus on new domains such as Cyber and Space, Artificial Intelligence, Hypersonics and Robotics.

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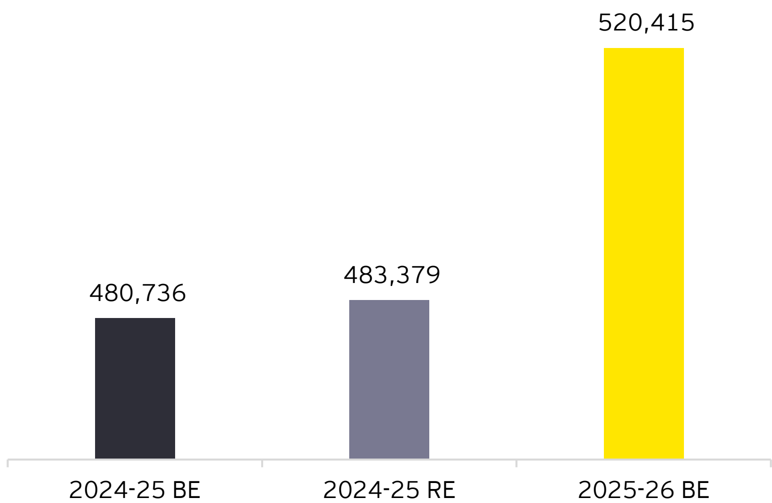
How does the budget impact Defense sector?

- Defense allocation is accounted for under four demands for grants:
  - Demand No 19 – Ministry of Defense (Civil)
  - Demand No 20 – Defense services (revenue)
  - Demand No 21 – Capital outlay on Defense services
  - Demand No 22 – Defense pensions
- The total Defense budget (excluding Defense pensions) for Financial Year (FY) 2025-26 is US$60.16 billion (INR5,20,415 crore)
- Budgetary allocation towards capital outlay stands at US$20.81 billion (INR1,80,000 crore)
- Revenue expenditure allocation stands at US$36.03 billion (INR3,11,732 crore)

Total Defense expenditure (excluding Defense pensions) (INR crore)



Brief on capital expenditure

- Modernization of military forces is mainly influenced by the annual capital allocation in the budget.
- The current capital budget, expressed in INR, has seen an increase of 4.65% over FY 2024-25 (BE)

Highlights

US$78.57 billion (INR6.81L crore)

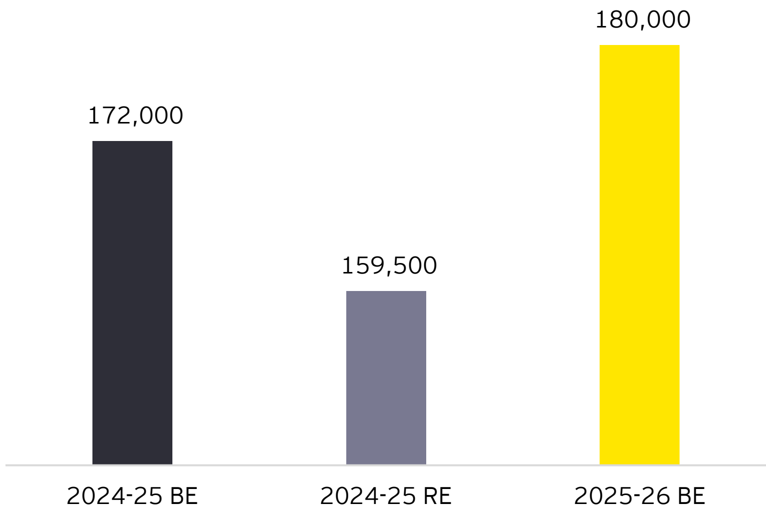
9.5% increase over FY 2024-25 (BE)

4.65% increase in capital outlay

US$20.76 billion (INR1.8L crore)

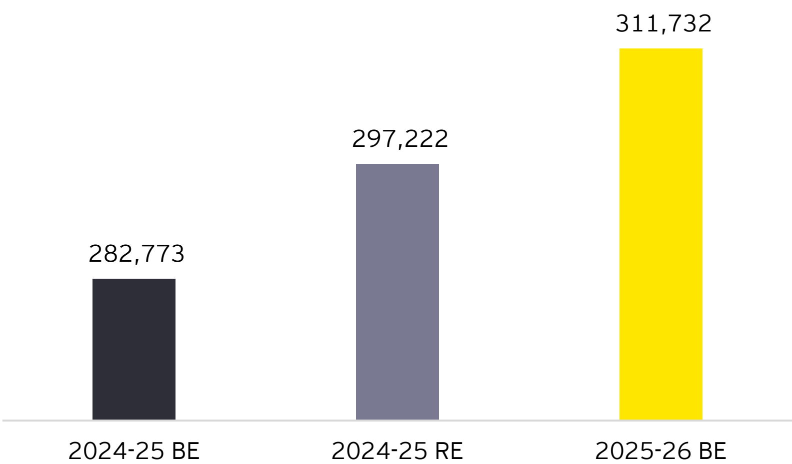
Capital Budget

Capital expenditure (INR crore)



- Closer examination of capital expenditure in INR terms shows an increase of ~21% and ~74% for aircraft and aero-engines and joint staff requirements over FY 2024-25 (BE) for the Defense services, respectively.
- The allocation for Heavy and Medium Vehicles is US$0.43 billion (INR3,650 crore) for FY 2025-26 (BE), a decrease of ~21% over FY 2024-25 (BE).

Revenue expenditure (INR crore)



- Budgetary allocation towards revenue expenditure for this year is US$36.03 billion (INR3,11,732 crore), an increase of 10.24% from FY 2024-25 (BE).
- When measured in INR currency terms, Indian Navy and Indian Air Force have witnessed the highest increase of 16% in revenue budget amongst the Indian Armed Forces over FY 2024-25 (BE).
- There is an increased allocation of 8% for Indian Army during the same period. The total allocation for Agnipath Scheme has seen an increase by 84% over FY 2024-25 (BE). Revenue R&D budget has been increased by 12% over FY 2024-25 (BE)

Highlights

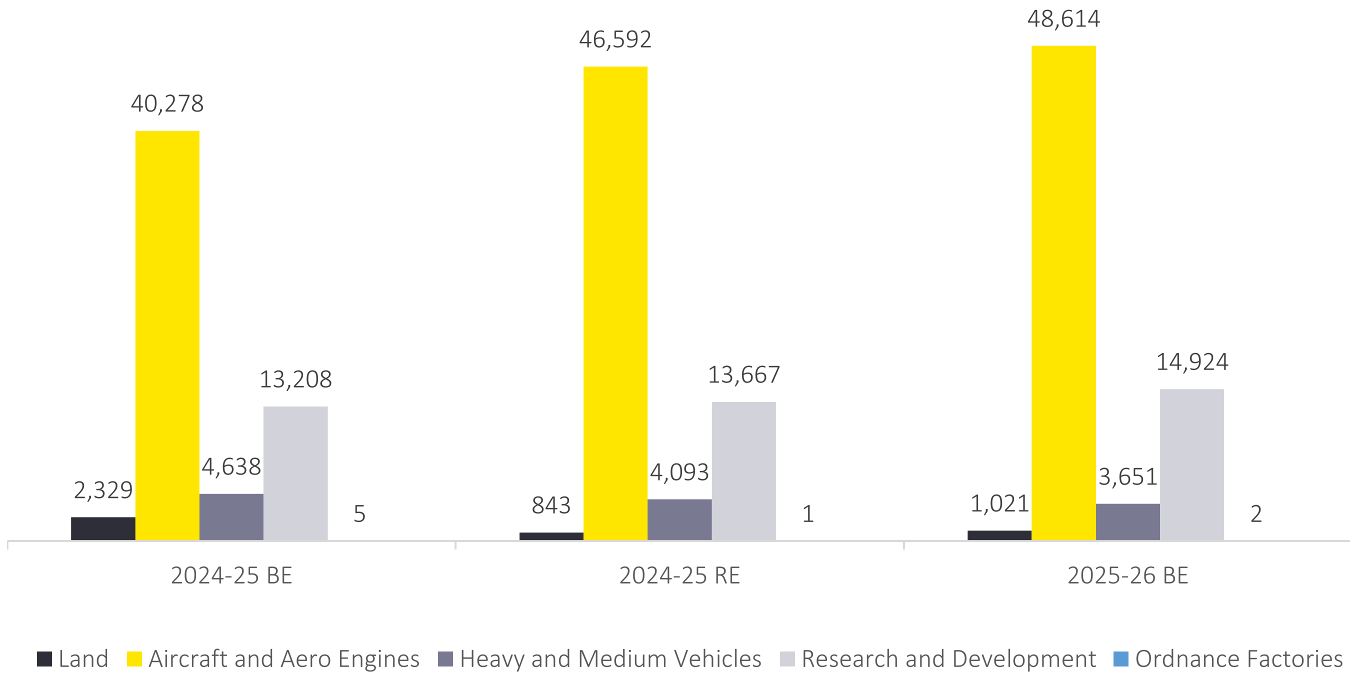
US$35.96 billion (INR3.1L crore)

Revenue Budget

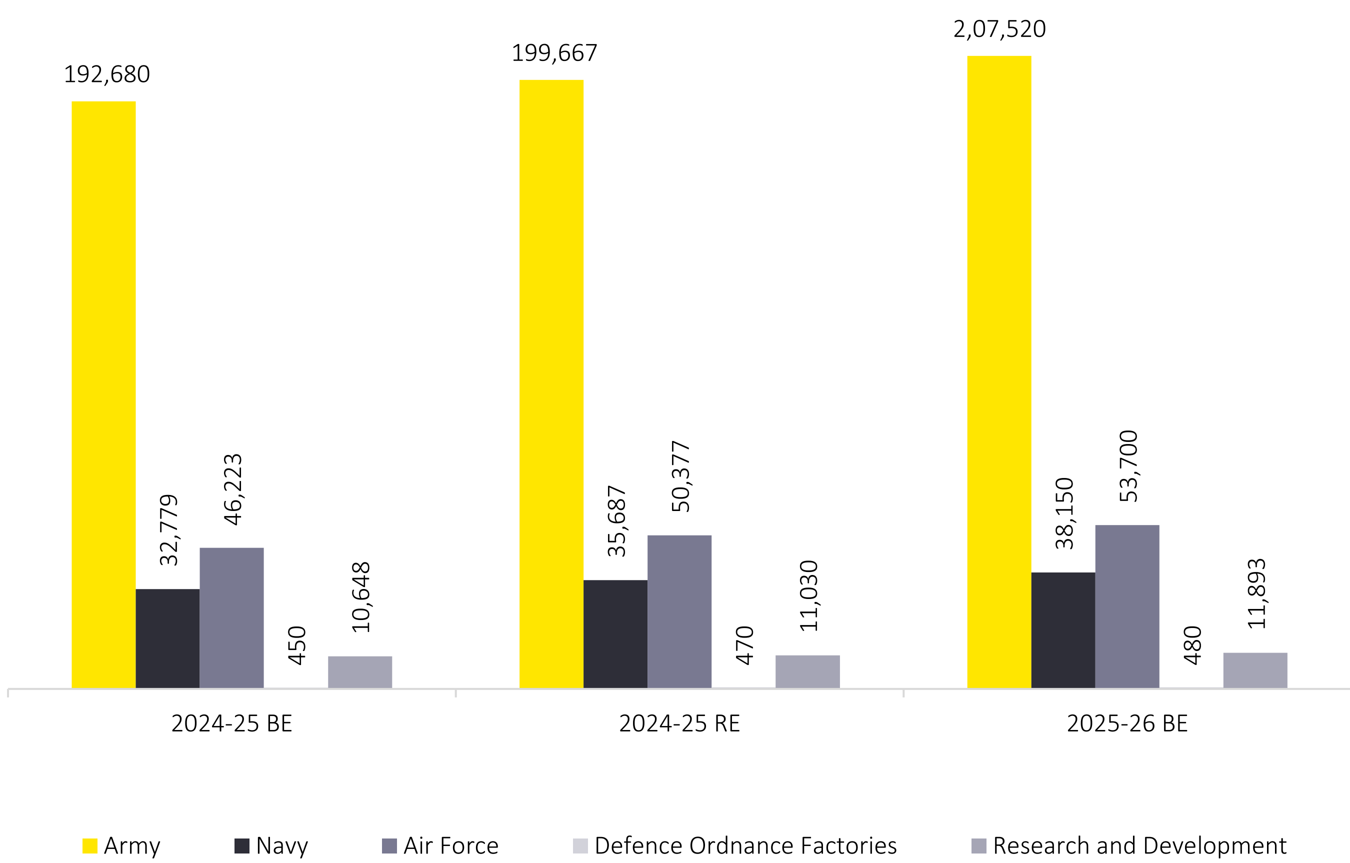
$30.68 billion (INR2.66L crore)

Modernization Budget

Breakdown of capital expenditure (INR crore)



Breakdown of revenue expenditure (INR crore)



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Tax announcements

Direct Tax:

- Extension of sunset date to 31 March 2030 for following tax exemptions linked to commencement of operations by IFSC unit engaged in leasing of aircraft or ship:
  - Tax exemption on royalty/ interest income paid by an IFSC unit to non-resident on leasing of aircraft or ship (extended from 31 March 2025)
  - Tax holiday on gains arising on sale of leased aircraft or ship (within the tax holiday period) by the IFSC unit (extended from 31 March 2025)
  - Capital gain exemption for non-resident or unit of IFSC engaged primarily in Aircraft leasing, from the transfer of equity shares of domestic company, being an IFSC Unit engaged primarily in Aircraft leasing (extended from 31 March 2026)
- Following exemption available for IFSC units engaged in Aircraft leasing have also been extended for ship leasing:
  - Capital gains exemption to Non-resident shareholders or IFSC units primarily engaged in ship leasing on the transfer of equity shares of domestic IFSC units primarily engaged in ship leasing, provided the gains are realized within 10 years of the investee unit's commencement of operations.
  - Exemption to IFSC units primarily engaged in ship leasing for dividend income received from IFSC units primarily engaged in ship leasing
- A New Income Tax Bill (Bill 2025) to be introduced in Parliament next week, which is expected to be:
  - Clear and direct in text, with close to half of the present law
  - Simple to understand, leading to tax certainty and reduced litigation
- TCS on sale of goods has been removed with effect from 01 April 2025. Certain other rationalisation measures introduced for TDS and TCS provisions
- A scheme for determining arm's length price of international transaction for a block period of three years will be introduced in line with global best practices, at the option of the taxpayers.
- To reduce litigation and provide certainty in international taxation and transfer pricing matters, the scope of safe harbour rules is being expanded.

Indirect Tax

- Rationalisation of Customs Tariff Structure as under;
  - Removal of seven Tariff rates from Customs Tariff. Now there will be eight remaining Tariff rates including 'zero' rate.
  - Application of not more than one cess or surcharge. Accordingly, Social Welfare Surcharge ('SWS') is to be exempt on 82 Tariff lines which are currently subject to a cess
- To facilitate and reduce the overall transaction cost to trade, definite time limit of two years, which may be extendable by one year, is to be fixed for finalisation of Provisional assessment under Customs.
- Exemption of Basic Customs Duty ('BCD') on raw materials, components, consumables, or parts for manufacture of ships / vessels and ships / vessels for breaking up, to be continued for another 10 years, which was due to get expired by 31 March 2025
- Supply of goods warehoused in a Special Economic Zone (SEZ) or Free Trade Warehousing Zone (FTWZ) to any person before clearance of such goods for exports or to Domestic Tariff Area (DTA) will be treated neither as supply of goods nor as supply of services under GST. It will eliminate the issue of double taxation since, Customs duties are payable, at the time of removal of goods into DTA.

Impact analysis

The Union Budget 2025 reinforces India's commitment to self-reliance in Defense and national security. With a budgetary allocation of INR6,81,210 crores (~US$ 78.57 billion) for the Defense sector which marks a 9.5% increase from previous year and a capital budget of INR1,80,000 crores (~US$ 20.76 billion), reflects a strong signal towards modernization and indigenous production of light combat aircrafts and helicopters, advanced military equipment, including drones, and next-gen weaponry. As seen in previous years, ~75% bifurcation of capital outlay budget can be envisaged for domestic industry which translates to ~INR1,35,000 crore (~US$ 15.57 billion). This aligns with the government's Atmanirbhar Bharat/ self-reliance vision, reducing dependency on imports and fostering India's position as a global Defense manufacturing hub.

Total modernisation budget is INR2,66,168 crore (~US$ 30.70 billion) for FY 2025-26 which is inclusive of capital outlay and stores, repairs, refits and works of revenue expenditure. The significant increase of ~21% for aircraft and aeroengines indicates likely acquisition of 97 Light Combat Aircraft (LCA) Tejas for IAF in the upcoming FY. Contracts for 156 Light Combat Helicopter (LCH) for Indian Air Force (IAF) and Indian Army, maritime fighter aircraft, artillery guns and submarines are also expected to be finalized.

There is an increase of ~26.46% over FY 2024-25 (BE) for Indian Coast Guard to cater for an increased surveillance in the Indian Ocean Region and additional infrastructure.

Another key focus is the integration of cutting-edge technologies such as artificial intelligence, cybersecurity, and surveillance systems within the armed forces. Investments in border security infrastructure and military training facilities will enhance operational readiness and preparedness for modern warfare. Furthermore, the budget places importance on the welfare of defense personnel, ensuring better healthcare, pensions, and support for veterans. Assistance for prototype development under Make procedure has witnessed a 13.27% increase over FY 2024-25(BE). Despite substantial budgetary provisions, development of certain systems appear to be delayed.

Total R&D budget this year is INR26,816.82 crore (~US$ 3.09 billion) which is a 5.15% of the total budget (less pensions). Of this, the capital R&D budget is INR14,923.82 crore (~US$ 1.72 billion) which has increased ~13% over FY 2024-25(BE). As announced in the past years, 25% (INR3,730 crores or ~US$ 430 million) of this is likely to be reserved for industry, startups and academia. The launch of three editions of Acing Development of Innovative Technologies with IDEX (ADITI) scheme has seen an overwhelming response from the Indian Industry and has reflected as 6.13% increase in Secretariat General Services. With dedicated funding towards research and development in defense technology of around 3.93%, Budget 2025 strengthens India's security landscape while fostering a robust ecosystem for indigenous innovation and exports in the global defense market and also re-affirms Ministry of Defense commitment to observe 2025 as a Year of Reform.

India's Defense exports touched a record INR21,083 crores as at end of FY 24 with a growth of 32.5% over the last fiscal. The same is expected to cross INR25,000 crore (~US$ 2.88 billion) at the end of this FY and along with estimated INR100,000 crore (~US$ 11.5 billion) in defence production is well on its way to meet the annual defence production target of the Government to reach US$ 35 billion and exports worth US$ 6 billion, respectively by FY 2028.

Glossary

MoD – Ministry of Defense

BE – Budgeted Estimate

RE – Revised Estimate

R&D – Research and Development

GST – Goods and Service Tax

MRO – Maintenance, Repair and Overhaul

BCD – Basic Customs Duty

TDS – Tax Deducted at Source

TCS – Tax Collected at Source

SEZ – Special Economic Zone

iDEX – Innovations for Defense Excellence

For details on other sectors and solutions visit our website Union Budget 2025

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