THE UNION BUDGET 2009-10

THREE CRITICAL DIMENSIONS

AMITHA SEHGAL
DIVYA VASANTHARAJAN
KANU H. DOSHI

FORUM
OF FREE ENTERPRISE

"Free Enterprise was born with man and shall survive as long as man survives".

- A. D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

EDITOR'S NOTE

As has been the trend in the recent past, there were a great deal of expectations about the budget 2009-10. This was not surprising. First, this happened to be the first budget of the newly constituted coalition Government, in which the Congress Party has a dominant position. Second, "the Left being Left out" was perceived to be a wonderful opportunity for the Government to push through some aggressive long-pending economic reforms. Last, all the stakeholders in the economy, especially the business and industry, were expecting that the economy to overcome the challenges of deceleration of the previous year required bold and innovative new initiatives.

Against this backdrop, the Forum is, indeed, greatly pleased to present to its readers the composite booklet incorporating three critical dimensions of the Budget 2009-10. In her presentation "The Union Budget 2009-10 - Does it dovetail with Vision 2020?", Prof. Amitha Shagal offers a macro perspective and critically examines various provisions of the budget and concludes "the Budget is flawed on two major counts: huge debt and a lack of focus on generating meaningful employment for all segments of the labour force."

In contrast, Prof. Divya Vasantharajan evaluates the micro impact of the budget on various sectors of the capital market and concludes on a very optimistic note that " the post budget events like possibility of good monsoon and favourable pronouncements on disinvestments by the government coupled with positive global cues of increased FII inflows suggest that Indian Capital Market is poised for major revival in terms of IPOs by companies, NFOs by Mutual Funds, decent retail participation, return of investors in the secondary markets, huge governmental spending on infrastructure and in rural areas, increased urban spending on white goods. In short, the next year promises to be bullish for the capital market which may see the Sensex again at 21,000".

The last presentation is from Chartered Accountant, Mr. Kanu Doshi, who objectively deals with direct tax proposals of the budget. While summing up the budget, he points out that "one gets a mixed feeling of some joy, some disappointment and some hope: Joy for abolishing of 10% surcharge on personal taxes and of Fringe Benefit Tax. Disappointment for continuation of 10% surcharge on company tax and also of 3% Education Cess on taxes of all categories. Hope for introduction of Direct Tax Code and reintroduction of SARAL for return of income".

Thus, the budget seems to convey different perspectives for different experts. Surely, the global economic crisis of 2008-09 has not only impacted the India growth story of 2003-08, but also damaged the fiscal health of the country. Consequently, fiscal expansion of fiscal deficits in 2008-09 and projected for 2009-10 has become inevitable. But this does not imply that the essence of FRBM discipline can be ignored.

It seems that the Finance Minister has decided on cautious and steady approach to the fiscal and economic policies. Challenges of global economic crisis -contraction of global economic output, global trade and capital inflows – require concerted response.At home, there are also downside risks of the monsoon playing truant and growth of money supply in relation to real GDP growth endangering the inflationary scenario in the latter part of the current year.

Also, there could be many more policy initiatives "off the budget" in the course of the year. Compulsion of the political economy that the budget alone should not be upfront about all the intentions of the coalition Government, may have weighed the FM's strategy. Will the current "green shoots" in economy blossom on a sustainable basis over the year? Will there be more aggressive economic reforms? Wait and watch!

Sunil S. Bhandare
- Editor

I
THE UNION BUDGET 2009-2010
DOES IT DOVETAIL WITH VISION 2020?

by

Amitha Sehgal*

Introduction

Acountry needs to dream. It needs to have a vision. Avision that is long term, comprehensive and realistic. At the beginning of the new millennium, in 2000 the Planning Commission, Government of India constituted a Committee on Vision 2020 for India under the chairmanship of Dr.S.P. Gupta, member Planning Commission.

The opening remarks of the Vision 2020 report published in 2003, states:

"It is important to see beyond the limits of India's recent past to discover the greatness that is India.

Although the present India is a young developing nation, our people have a rich and illustrious history as one of the longest living civilisations in the world.

Even Lord Macaulay, the British historian politician had to admit before the British parliament: *"I have travelled across the length and breadth of India and 1 have not seen one person who is a beggar, who is a thief. Such wealth 1 have seen in this country, such high morals values, people of such high caliber...*

The author is Senior Faculty, R.A.Podar Collage of Commerce & Economics, Mumbai, and visiting faculty, Welingkar Institute or Management, Mumbai.

the very backbone of this nation, which is her spiritual and cultural heritage...."

It is hoped that every step the present government takes to shape India, must be in the direction of rediscovering its rich cultural and spiritual values that have always been the foundation of India's economic prosperity. The question that needs to be asked is: how far does the Union Budget 2009-2010 dovetail with the Vision 2020? Two aspects that need to be addressed while answering this question are: the state of the government's fiscal petformance and to what extent does the Budget have a potential for employment generation. It will be difficult for a country, in deep debt and without sufficient jobs for its citizens, to reclaim its rich heritage.

The Union Budget 2009-2010: Preparing for the marathon?

The dream run up to the elections was marked by fiscal prolificacy. While this assured that the Congress party managed to stay ahead of the pack, tho Budget presented on July 7 showed up as a poor report card for the state of our economy.

A quick summary of the macro-fiscal position of India reveals that there is a dip in the growth in GDP at 6.7 per cent from an average over 9 per cent in the previous three financial years. India has become more vulnerable to external shocks because of the 'coupling effect', The share of merchandise trade (exports plus imports) as a proporlion to GDP has more than doubled in the last decade to 38 9 per cent in 2008-09 Similarly trade in qoods and services has more than doubled to 47 per cent during this period Also gross capital flows rose to a peak of over 9 per cent of GDP n 2007 08, before fallin ; in the wake of the financial crisis

A combination of increased subsidies (BE 2009-2010 at Rs.1,11,276 crores), higher State borrowings (FRBM Act

relaxed to allow them to increase borrowing to 4 per cent of GDP from the current 3.5 per cent), and a 36 per cent increase in government spending, will lead to fiscal deficit reaching 13 per cent of GDP.

More worrisome is the cash flow position of the government. Borrowings accounts for biggest share of the receipts at 34 per cent. There is a huge gap in government finances with revenue deficit budgeted to go up by a whopping 412 per cent from the Budget estimates for 2008-09. Interest payments account for 56 per cent of the fiscal deficit.

Even as expenditures mount, the revenues are expected to shrink with the tax to GDP ratio is expected to come down to 10.9 per cent, from 11.6 per cent of GDP. In FY09, tax revenues were up a mere 6 per cent. But in FY10, the increase in tax revenues has been pegged at just 2 per cent.

Among the biggest disappointments on the revenues side was the woefully low target of Rsl, 100 crores for the current fiscal year in disinvestment receipts.

On a posilive note, the government is attempting to fill up the slack in private sector capital investment due to the global meltdown. Budgeted capital expenditure is up a good 26.8 per cent, although part of that is capital expenditure on defence. If we exclude that, capital expenditure (both Plan and non-Plan) is higher by 21.7 per cent.

"Common Good of All" – A Myth or a Reality?

The finance minister had begun his Budget Documents with this quote by ***Mahatma Gandhi.***

"Democracy is the art & science of mobilizing the entire physical, economic and spiritual resources of various sections of the people in the service of the common good of all".

This Budget is primarily a demand-pull budget. An estimate by the finance ministry puts a figure of Rs.9,500 cores as additional disposable income in the hands of consumers because of beneficial personal income-tax provisions in the Budget, i.e. increasing exemption limits and doing away with the surcharge.

It hopes that increased consumption will propel growth and this in turn with help initiate economic reforms. This hypothesis has flaws.

Tax incentives and various social schemes, especially the NREGS will put more money into the hands of people leading to a surge in consumption.

According to the Economic Survey, private final consumption expenditure at constant prices grew at 8.1 per cent per annum in 2007-08 as compared to 6.4 per cent in 2006-07. Consumption of food, beverages and tobacco constituted a huge 42.3 per cent of the total expenditure!!! It is not surprising that even as the Sensex slid by 5.8 per cent post-budget, stocks in the FMCG sector gained almost 8 per cent, in anticipation of an increase in the propensity to consume by rural and urban middle class. ITC was the only company whose share price increased by 3 per cent as, contrary to market expectations; there was no increase in taxes/excise on cigarettes.

This brings us to the question: is improved consumption an indication of development? Will increased consumption help us reclaim our rich economic and spiritual heritage – as stated in Vision 2020?

Aconsumption-led strategy, in itself, has merits for a country with a huge pent-up demand like India, but it should not be at the expense of creating gainful employment.

It is also doubtful that such a strategy will propel India to a high trajectory of growth leading to the stated ideal by Mahatma Gandhi: "common good of all"

The primary objective of economic activity is to provide opportunities and encouragement to people so that they can pursue their inner desires. Development is all about creating more jobs every year and a steady improvement in the quality of life of the largest number of people. Indian ethos emphasizes that work per se is much more important, than any form of superior consumption, for the evolution of an individual. Even in this age of globalization and coupling with other world economies with the resultant influx of a global work culture, an average Indian while leaving home to go to his job says: "I am going for my duty." The work is looked upon as a means of not just earning a livelihood but of fulfilling his dharma-his duty to family, society and his own inner yearnings.

Unfortunately in India unemployment numbers are not tracked and documented in real time. Unlike in other countries like the United States where the Labour Department releases unemployment statistics with detailed industry wide breakup every fortnight, in India, the latest Economic Survey, released in July, 2009 has numbers that are three years old. There is a sample study of the impact of the recent economic crisis on employment but it covers just around 2,500 units.

Estimates place unemployment at between 6.5 to 8.2 percent. However, that number is thought to largely reflect unemployment in the organized sector of the economy, which comprises just 10 percent of the country's workforce.

Access to gainful employment is an essential condition for citizens to exercise their economic rights in a market democracy. India's vision for 2020 is founded on the premise of Jobs for

All. It states that employment must be considered a constitutional right of every citizen.

What is especially disturbing is that while India has achieved economic progress due to the reform process, but there has been an alarming rise in the rate of unemployment in India, up from 7.3 per cent in 1999-2000 to 8.35 percent in 2004-05. According to the Economic Survey, employment growth in the organized sector, public and private combined, declined during the period between 1994 and 2006. This has primarily happened due to decline of employment in organized public sector. Employment in establishments covered by Employment Market Information System of the Ministry of Labour grew at 1.20 per cent during 1983-94 (pre-reform) but decelerated to 0.12 per cent per annum during 1994-2006 (post-reform). However, the latter decline was mainly due to a decrease in employment in public sector establishments, whereas the private sector had shown acceleration in the pace of growth in employment from 0.44 per cent to 0.92 per cent per annum.

[1] The public sector will continue to shed jobs. Although the private organized sector will contribute significantly to the growth of the economy, its contribution to the overall employment generation will be modest, since total employment in this sector currently represents only 2.5 per cent of all jobs. Even if this sector grows by 30 per cent per annum, over five years it will contribute less than one per cent to the growth of the workforce, according to the Planning Commission.

Policy makers need to accept the fact that despite a persistent tendency to associate employment with large industry

1 Report of the Commission on India vision 2020, Planning Commission, Govt. of India, Academic Foundation. New delhi 2003.

in the organized sector, an in-depth examination of employment potential makes it evident that the largest share of new jobs will come from the unorganized sector. This sector contributes over 90 per cent of the country's employment and generates seven times greater labour intensity per unit of production, as compared to the organized sector.

There is a need to support the Small and Medium Enterprises (SMEs) sector. International comparisons too validate this observation. In the USA, nearly three-fifths have less than five employees. In Japan, 78 per cent of jobs are generated by SMEs. The small and medium manufacturing enterprises in South Korea account for 99 per cent of all manufacturing enterprises and employment in this sector accounts for 69 per cent of the total.

The Budget has taken a few positive steps that focus on employment. It aims at creating 12 million new jobs every year. It also introduces a welcome change in the operation of Employment Exchanges with Public Private Partnership. In addition to the concern of generating employment, an equally important concern is improving employability among job seekers. To improve skill development training to the country's unemployed youth; the Budget has an outlay of Rs.450 crores for revamping the country's industrial training institutes (ITIs) this year.

The Budget also continues to offer interest subvention, up to March 31, 2010, to seven key export-oriented sectors like textiles including handlooms, leather, gems and jewellery.

Micro, Small and Medium Enterprises (MSMEs) have been affected by the slowdown in exports and the indirect effect of the global crisis on domestic demand. To support this sector, the Budget proposes to facilitate the flow of credit at reasonable

rates, by providing a special fund out of Rural Infrastructure Development Fund (RIDF) to Small Industries Development Bank. This fund of Rs. 4,000 crores will incentivise Banks and State Finance Corporations to lend to Micro and Small Enterprises (MSEs) by refinancing 50 per cent of incremental lending to MSEs during the current financial year.

The electronic hardware industry has a strong potential for creating employment especially in the SME sector. The Budget reduced the basic Customs duty on LCD panels from 10 per cent to 5 per cent to support indigenous production of LCD televisions. There is also a second one-year extension of tax holiday for small and mid-size IT and BPO companies.

But most of the measures have a short term, fire-fighting approach. It is not possible for SMEs/MSEs/IT/BPO companies to do any reasonable planning for their future based on Budget provisions covering just one financial year.

The Budget does not reflect any long-term commitment of the government to view SMEs as a vehicle for new technology adaptation, entrepreneurship and employment generation.

It is imperative that government formulates a progressive exit policy for industry that allows young entrepreneurs to start and exit businesses in a true entrepreneurship spirit. There is also an urgent need to change archaic labour laws. These have compelled employers to hire workers on contractual basis to avoid the hassles of an unionised labour force. Consequently, much of the new labour force is unprotected and does not enjoy security or retirement benefits.

Sectors like hotel and tourism, identified as high employment potential sectors, have been badly affected by recent terrorist attacks. The Budget does not have any provisions to help this sector.

This brings us to the main thrust area of the Budget—welfare of the 'Aam Adami' and the contribution of The National Rural Employment Guarantee Act (NREGA). It guarantees a real wage of Rs. 100 a day, as an entitlement, to one employable person in rural India per household. During 2008-09, NREGA provided employment opportunities for more than 4.47 crore households as against 3.39 crore households covered in 2007-08. There is an allocation of Rs. 39,100 crores for the year 2009-10 for NREGA, which marks an increase of 144 per cent over 2008-09 Budget Estimates (BE).

The work projects included in the Scheme cover rural connectivity, flood control and protection, water conservation and water harvesting, drought proofing, micro irrigation, provision of irrigation facility to land development, renovation of traditional water bodies, land development, and any other activity approved by the Ministry of Rural Development.

While, the outcomes of these projects on the rural India landscape are yet to be assessed, the Scheme does not take into account that the present wages in dry land agriculture and wages of farm workers is far below the Rs.100 entitlement. It is becoming increasing difficult to get farm workers to engage in their primary duty—farming!! The new wages will further crowd out private employment in farming. Another area of neglect is livestock management. About a quarter of the value added in agriculture comes from livestock that is particularly important to the livelihoods of poor rural households. Opportunities for public investment are huge in this area.

The Budget's focus on welfare-oriented inclusive growth by Schemes like the NREGS's make-work programmes, appears flawed in the context of the central hypothesis of this article, that the true purpose of development is "help an average

Indian pursue his inner desire, his true calling, by offering him opportunities to earn his livelihood with dignity and a sense of satisfaction?"

We had hoped to see some more path-breaking employment reforms that could correct the distortions in farm and non-farm labour markets.

In Conclusion

This article postulates that the Budget is flawed on two major counts: huge debt and a lack of focus on generating meaningful employment for all segments of the productive labour force - unskilled, semi-skilled skilled and professional educated workers; farm and non-farm rural workers and at the far-end of the spectrum, graduating young potential entrepreneurs from the IIMs and IITs campuses.

The problem of huge debt may be handled by fiscal and accounting creativity. For example the Government is exploring ways to change the character of the National Investment Fund (NIF) so that it can partially meet the expenditure of the Government's social sector obligations.

At present, divestment proceeds the government receives while selling its stake in Public Sector units has to be transferred to the NIF and the Government cannot use these funds (the corpus stands at a modest Rs.4000 crores at present) though it can use the returns generated by the Fund.

What remains a huge concern is that the Budget gives no direction to significant employment generation, which can channelise the aspirations and capabilities of the growing youth segment of India's population.

II

IMPACT ON CAPITAL MARKET

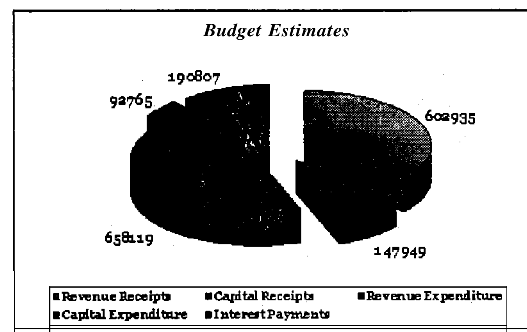
by

Divya Vasantharajan*

India Past Performance Overview

INDICATOR	2007-08	2008-09	2009-10E
GDP	9%	6.7%	6.2%
Fiscal Deficit	2.7%	6%	6.8%
Revenue Deficit	1.1%	4.4%	4.8%
Primary Deficit	-0.9%	2.5%	3%
Inflation	7.5%	10%	3.5%
Interest Rates	8%	9%	7.5%
Foreign Trade	150bn$	155bn$	180bn$
Agriculture	3%	1%	3.5%
Industry	3%	1.7%	0.5%
Services	3%	4%	1.2%

Budget Estimate Pie **(in Rs. Crore)**



* The author is Research Associate, Welingkar Institute of Management, Mumbai

The Indian equity markets have turned bullish for the last few months and got huge relief that the solidity in the economy will be supplemented by political stability. The Nifty has gained almost 60% since the lows of March 2009. The week preceding the budget was driven by a high degree of optimism in many sectors owing to high expectations from the budget, hoping for credible economic measures in the hour of global crisis. Many PSUs were stalked in the market for disinvestment plans.

On the economic front, although the GDP growth rate has mellowed to 6-6.5% from the highs of 9% through the years 2003-04 to 2007-08, India still is one of the favoured economies.

While the Budget has announced some reforms in some areas, it has failed to acknowledge any clear outline of the future of basic parameters like employment, rural participation, PSU divestments and easing of FDI norms in some sectors.

Corporate tax rates have remained largely unchanged, except 5% rise in MAT and abolishment of FBT. Reforms are announced in the form of introduction of the Goods and Services Tax (GST) from April 1, 2010 and higher allocation of expenditure for National Highways Authority of India.

Thus, initial reaction of the stock market was of a major let down. But as on August 3, markets have got over that disappointment thanks to several developments, most important being revival of the monsoon and sustained flow of excellent corporate results.

POWER: The power sector did not attract any specific attention. IIFCL can now re-finance infrastructure projects. Allocations for the APDRP and RGGVY programmes have been increased by 160% to Rs 20.8 billion and by 27% to Rs 70 billion, respectively. Hike in MAT by 5% would have a neutral impact,

as it will be transferred to the end users. On the renewable energy front, the basic customs duty on permanent magnets used in wind power generation has been reduced from 7.5 %to 5 per cent.

India has power shortage of 70,000 MWatts and needs to ensure growth in production to meeting demands of the industries and household sector. As a result over the period of 18 months, power companies and allied sectors stand to gain from the demand-supply mismatch. Wind mills found a huge market in the last year owing to the tax shield. However, this business may not see an upturn in the immediate future.

OIL & **GAS:** The extension of tax holiday under Section 80-IB on natural gas production is a positive. The National Gas Grid has received cognizance. It may lead to a better response to future NELP rounds. 100% deduction for all capital expenditure on cost of pipelines will entail a better distribution system.

Excise duty on naphtha has been lowered to 14%. This will positively affect the margins on naphtha-based products. Government has planned to accelerate the 220,000 tpa Assam gas cracker project.

World oil production has rested at 82 million barrels per day for the better part of the last 3 years. However, while US tops the consumption chart at 22%, which is a drop in the last 3 years from 24%. Both India and China have nearly doubled consumption to 3% and 10% respectively. At this growth rate, there is a serious widening gap between demand and supply. As a result, oil production and exploration companies stand to gain from the escalating domestic demand. Dependence on non-renewable sources of energy will have to decrease and hence, there will be serious growth in relevant R&D expenses.

PORTS: The budget has levied a service tax on the shipment

of goods through the coastal & inland waters route. This tax may not have a major impact owing to the inexpensive coastal mode of transport. The increase in MAT will have negative impact on the revenues of players.

Indian coastline is long. However, infrastructure-wise no Indian port has the capacity to berth either a ULCC (Ultra Large Crude Carriers) or VLCC (Very Large Crude Carriers). Considering burgeoning demand for Capital Goods and raw materials, we have a strong requirement for development of ports and docks..

ROADS: Allocation for NHDP has increased by 23%, project implementation is expected to be slow due to various policy concerns. Allocations to PMGSY have increased by 59% in 2009-10. However, it may prove insufficient as it has

Refinancing commercial bank loans through IIFCL will facilitate more loans towards new projects. Increase in MAT will have negative impact.

CONSTRUCTION: Higher capital expenditure will aid construction growth in infrastructure segment. The additional support for PPP projects through IIFCL refinancing will ease funding pressures. Removal of excise duty on prefabricated concrete blocks will result in improvement in margins.

STEEL: Higher investment in infrastructure like roads, railways and urban infrastructure under Jawaharlal Nehru National Urban Renewal Mission, the demand for steel will improve marginally. Capital expenditure for Commonwealth Games hosted by India is likely to cause a higher demand.

AGRO-BASED: Subsidies in fertilizers to move from product-based to nutrient based. Innovative proposition to introduce a system of direct subsidies to farmers has been made. Allocation for fertilizer subsidy has been lowered to Rs 502 billion. Greater

thrust on credit and .irrigation facilities is expected to boost agriculture in the long run.

WHITE GOODS: The reduction in customs duty on LCD panels from 10% to 5% will boost demand in capital goods, coupled with the removal of 10% surcharge this sector may see good growth.

HOUSING: Scheme to allocate funds of around Rs. 40 bn to the Urban Poor will provide housing to low income groups. Further allocation of Rs 88 bn under Indira Awaas Yojana and Rs 20 bn for Rural Housing Fund through National Housing Board will further aid in reduction of rural housing shortage.

INFORMATION TECHNOLOGY: Impact on this industry may be marginally positive in that the FBT is scrapped which was a large tax outflow and extended tax holiday of a year (sections 10A and 10B). Abolishment of duty on packaged software is a measure to provide impetus to the industry.

PHARMACEUTICALS: Customs duty has been reduced by 5% and exemption of CVD on imports of select life-saving drugs and their bulk drugs will have some impact.

TELECOM: Full exemption from customs duty on accessories of mobile handsets for 1 year will benefit this sector.

TEXTILES: Extension of **2%** interest subvention on pre and post shipment export credit will help exporters. Excise duty on cotton textiles has been increased to a 4% from a 0% optional duty. Excise duty on man-made fibres and yarns has been raised to 8% from earlier levels of 4%.

AUTO COMPONENTS & TYRES: Tax holiday extension by a year for export oriented units will help very few players. Interest support of 2% for availing packing credit will benefit SMEs engaged in exports. Thrust on rural spending will be the key driver for tractor and two-wheeler sales thereby, benefiting sales to original equipment manufacturers.

AUTOMOBILES: The reduction in specific additional duty on passenger car and utility vehicles above 2,000 cc from Rs 20,000 to Rs 15,000 was a mild attempt to be favorable towards the slumping sector. Rural demand and the IT exemption stand to be the demand drivers for the two wheeler market. Higher fund allocations for irrigation will impact tractor sales positively.

BANKING AND FINANCE: Government borrowing from domestic markets will be higher which will keep interest rates high. This could result in mark to market losses on the G-Sec papers that banks hold as per SLR requirements. As a result, banks may show some underperformance in that area.

Refinancing schemes will enhance credit flow to small enterprises and rural housing. For 2009-10, banks have been directed to lend Rs 3,250 billion to the farm sector - 13% more than the previous year. However, continuation of interest subvention scheme and additional subvention of 1% to farmers along with extension of debt waiver and debt relief scheme might impact the banks' profitability.

CONCLUSION: Post budget events like possibility of good monsoon and favourable pronouncements on disinvestments by the government coupled with positive global cues of increased FII inflows suggest that Indian Capital Market is poised for major revival in terms of IPOs by companies, NFOs by Mutual Funds, decent retail participation, return of investors in the secondary markets, huge governmental spending on infrastructure and in rural areas, increased urban spending on white goods.

In short, the next year promises to be bullish for the capital market which may see the Sensex again at 21,000.

III

DIRECT TAX PROPOSALS

by

Kanu H. **Doshi***

Author's Note: What follows is a broad summary of budget proposals affecting direct taxes. An attempt is made to highlight only those changes of interest to most of the tax payers. To ensure appreciation of the rationale of the changes, reliance is drawn from the memorandum explaining the provisions of the Finance Bill.

Introduction: The provisions of the Finance (No.2) Bill, 2009 relating to direct taxes seek to amend the Income-tax Act, mainly to lower the burden on the individual taxpayers by increasing the basic exemption limit; to introduce a novel presumptive tax scheme for small businesses; to encourage the growth of foreign investment in India by providing a speedy dispute resolution mechanism and simplification of provisions relating to tax deduction at source.

Tax rates, surcharge, education cess: Important features of the tax rates for assessment year 2010-11. Individual, Hindu undivided family, association of persons, body of individuals, artificial juridical person .

The basic exemption is to be increased from Rs. 1,50,000 to Rs. 1,60,000. The new rates of income-tax on total income in such cases will be:

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* The author is a Chartered Accountant and also Dean - Finance, Welingkar Institute of Management, Murnbai

Upto Rs. 1,60,000	- Nil.
Rs. 1,60,001 to Rs. 3,00,000	- 10%
Rs. 3,00,001 to Rs. 5,00,000	- 20%
Above Rs. 5,00,000	- 30%

In the case of individual, being a woman resident in India, and below the age of 65 years at any time during the previous year, the exemption limit is to be raised from Rs. 1,80,000 to Rs. 1,90,000. The new rates of income-tax on total income in such cases will be as under—

Upto Rs. 1,90,000	- Nil.
Rs. 1,90,001 to Rs. 3,00,000	- 10%
Rs. 3,00,001 to Rs. 5,00,000	- 20%
Above Rs. 5,00,000	- 30%

In the case of individual, being a resident in India, who is of the age of 65 years or more at any time during the previous year, the exemption limit is proposed to be raised from Rs. 2,25,000 to Rs. 2,40,000. The new rates of income-tax on total income in such cases will be as under—

Upto Rs. 2,40,000	- Nil.
Rs. 2,40,001 to Rs. 3,00,000	- 10%.
Rs. 3,00,001 to Rs.5,00,000	- 20%.
Above Rs. 5,00,000	- 30%.

No surcharge shall be levied. However, education cess of 3% of income tax is to be continued.

Companies: Rate of tax; surcharge & education cess:

The rate of 30% income-tax in the case of companies is the same as that for the assessment year 2009-10.

Amount of income-tax computed in the case of domestic company having total income exceeding 1 crors rupees, is to be

increased by a surcharge at the rate of 10% of such income tax. In the case a non-domestic company having total income exceeding 1 crore rupees, is to be increased by a surcharge at the rate of 2.5% of such income tax.

Additional surcharge called the "Education Cess on Income-tax" and "Secondary and Higher Education Cess on income-tax" shall continue to be levied at the rate of 2% and 1% respectively, on the amount of tax.

Deduction in respect of Interest on loan taken for higher education: Section 80E

Section 80E of the Income-tax Act provides for deduction to individual on account of any amount paid by him in the previous year by way of interest on loan taken from any financial institution or any approved charitable institution for the purpose of pursuing higher education in specified fields of study. Deduction is presently available only for pursuing full time studies for any graduate or post-graduate course in engineering, medicine, management or for post-graduate course in applied sciences or pure sciences including mathematics and statistics.

Section 80E is to be amended to extend its scope to cover all fields of studies (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority.

Enhancement of the limit for payment of advance tax: Section 208

Under the existing provisions of section 208 the Income-tax Act, liability for payment of advance tax arises only when the amount of tax is five thousand rupees or more. It is proposed to raise the limit to 10 thousand rupees.

Enhancement of the limit for payment of wealth tax to Rs. 30 lacs

Under the existing provisions of section 3 of the Wealth-tax Act, wealth tax is charged every year in respect of net wealth, on the valuation date, of every individual, Hindu undivided family and company at the rate of 1% of the amount by which the net wealth exceeds fifteen lakh rupees. It is now proposed to raise the threshold limit for payment of wealth tax from fifteen lakh rupees to thirty lakh rupees.

Tax relief on anonymous donations in certain cases Section 115BBC

Under the current provisions of section 115BBC, wholly religious entities are outside the purview of taxation of anonymous donations. Partly religious and partly charitable entities have also been exempted from the taxation of anonymous donations, except where the anonymous donation is made to an educational or medical institution run by such entity in which case such donations are taxed at the rate of 30%. In the case of wholly charitable entities, all anonymous donations are taxed at the rate of 30%.

In order to mitigate the compliance burden, it is proposed to provide relief to such organizations by exempting a part of the anonymous donations from being taxed. The proposed amendment will result in anonymous donations received by wholly religious institutions shall remain exempt from tax. In the case of partly religious and partly charitable institutions, anonymous donations directed towards a medical or educational institutions run by such entities shall be taxable only to the extent such donations exceed 5% of total income of such trust or institution or a sum of Rs.1 lakh, whichever is more. In the case of wholly charitable institutions, anonymous donations

shall be taxable to the extent such donations exceed 5% of total income of such trusts/institution or a sum of Rs.1 lakh, whichever is more.

Remuneration to partners in a firm: Section 40(b)(v)

Under the existing provisions of the Income-tax Act, the payment of salary, bonus, commission or remuneration to a working partner of a partnership firm is allowed as deduction if it is authorized by the partnership deed and subject to the overall ceiling of monetary limits prescribed under sub-clause (v) of clause (b) of section 40.

It is proposed to make upward revision of the existing limits of the remuneration. It is also proposed to prescribe uniform limits for both professional and non professional firms for simplicity and administrative ease. The revised limits are proposed to be as under:

(a) On the first Rs. 3,00,000 of the book-profit or Rs. 1,50,000 or at the rate of 90% of the in case of a loss book-profit, whichever is more;

(b) On the balance of the book-profit at the rate of 60%;

Weighted deduction for in-house research and development Section 35(2AB)

Under the existing provisions of the Income-tax Act, under sub-section (2AB) of section 35, weighted deduction of 150%. is allowed to a company engaged in the business of biotechnology or in the business of manufacture or production of drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board and which has incurred expenditure (excepting on land and building) on in-house scientific research and development facility approved by the prescribed author-

ity. With a view to promoting research and development in all sectors of the economy, it is proposed to extend the benefit of weighted deduction to companies engaged in the business of manufacture or production of an article or thing except those specified in the Eleventh Schedule of the Income-tax Act. The proposed amendment will take effect from 1st April, 2010 and will, accordingly, apply in relation to assessment year 2010-11 and subsequent years. In other words, expenditure on research and development incurred by the company during the financial year 2009-2010, will be eligible for aforesaid weighted deduction under section 35(2AB) of the Income-tax Act.

Donations to Certain Funds, Charitable Institutions, etc. Section 80G

Section 80G of the Income-tax Act, 1961 provides for a deduction in respect of donations to certain funds, charitable institutions, etc. subject to, the condition that such institutions and trusts arc established for 'charitable purpose'.

It is now proposed to provide that the approval once granted shall continue to be valid in perpetuity. Further, the Commissioner will also have the power of withdraw the approval if the Commissioner is satisfied that the activities of such institution or fund are not genuine or are not being carried out in accordance with the objects of the institution or fund.

Deduction in respect of contributions to political parties Section 80GGB & 80GGC

Section 80GGB and section 80GGC of the Income-tax Act, 1961' provide for deduction in respect of contributions given to political parties by companies and any person respectively. With a view to reforming the system of funding of politic4 parties it is proposed to amend section 80GGB and section 80GGC of the Income-tax Act, 1961 to provide that donations

to electoral trusts shall be allowed as a 100 percent deduction in the computation of the income of the donor. It is also proposed to consequently amend sub-clause (iia) of clause (24) of section 2 of the Income-tax Act to provide that donations to such electoral trusts shall be treated as income of the trusts which will be specifically exempt as per the newly inserted section 13B and not included in the total income of the previous year / subject to fulfillment of stipulated conditions.

(a) the electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during previous year 95 percent of the aggregate donations received by it during the said previous year along with the surplus, if any, brought forward from any earlier previous years

(b) the electoral trust functions in accordance with the rules made in this regard by the Central Government.

Further, "eletoral trust" has been defined in the new clause (22AAA) of section 2 as a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

These amendments will take effect from 1st day of April, 2010 and shall accordingly, apply in relation to assessment year 2010-11 and subsequent years.

Extension of sunset clause for units in free trade zone under section 10A and for export oriented undertakings under section 10B

Under the existing provisions, the deductions under section 10A and section 10B of the Income Tax Act are available only upto the assessment year 2010-11. It is proposed to amend sections 10A and 10B to extend the tax benefit under both

these sections by 1 year i.e., the deduction will be available upto assessment year 2011-12.

Definition of the term "manufacture": section **2(29BA)**

A number of tax concessions under the Income-tax Act are provided for encouraging manufacture of articles or things.

However, the term "manufacture" has not been defined in the statute. Therefore, it has been the subject matter of dispute and resultant judicial review in a number of cases. In order to remove any kind of ambiguity which may still persist in this regard, it is proposed to insert a new clause (29BA) in section 2 so as to provide that 'manufacture', with all its grammatical variations, shall mean a change in a non-living physical object or article or thing, —

(a) Resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) Bringing into existence of a new object or article or thing with a different chemical composition or integral structure.

This amendment will take retrospective effect from the 1st day of April, 2009 and will, accordingly, apply in relation to assessment year 2009-2010 and subsequent years.

Fringe Benefit Tax abolished

The Finance Act, 2005 had introduced a new levy, namely, Fringe Benefit Tax (FBT) on the value of certain fringe benefits.

It is proposed to insert a new section 115WM to abolish the fringe benefit tax. Consequently, it is also proposed to restore the taxation of the fringe benefits as perquisites in the hands of the employees with effect from assessment year 2010-11.

Minimum Alternate Tax: Section **115JB**

The Income-tax Act is riddled with a plethora of tax incentives which has the effect of considerable eroding the tax base. The Minimum Alternate Tax (MAT) is designed to achieve this objective.

Under the existing provisions of section 115JB of the Income Tax Act, a company is required to pay a minimum tax on its book profits, if the income-tax payable on the total income, as computed under the Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2007, is less than such minimum. The rate of the minimum tax is 10% of the book profit. It is proposed to amend sub-section (1) of section 115JB to increase the MAT rate to fifteen%, from the existing level of 10%.

However, with a view to provide relief to the assessees, being companies, who pay Minimum Alternate Tax under section 115JB for any assessment year beginning on or after the 1st day of April, 2006, it is also proposed to amend the provisions of sub-section (3A) of section 115 J M so as to provide that the amount of tax credit determined under sub-section (2A) of section 115JAA shall be allowed to be carried forward and set off upto the tenth assessment year immediately succeeding the assessment year in which the tax credit becomes allowable under sub-section (1A) of the said section.

Determination of arm's length price in cases of international transactions

Section 92C of the Income-tax Act provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. As a result, a large number of such transactions are being subjected to adjustment giving rise to considerable

dispute. Therefore, it is proposed to empower the Board to formulate safe harbour rules i.e. to provide the circumstances in which the Income-tax authorities shall accept the transfer price declared by the assessee.

This amendment will take effect from 1st April, 2009.

Further, the proviso to sub-section (2) of section 92C provides that where more than 1 price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding five% of such arithmetical mean.

The above provision has been subject to conflicting interpretation by the assessee and the Income Tax Department. The assessee's view is that the arithmetical mean should be adjusted by 5% to arrive at the arm's length price. However, the department's contention is that if the variation between the transfer price and the arithmetical mean is more than 5% of the arithmetical mean, no allowance in the arithmetical mean is required to be made.

With a view to resolving this controversy, it is proposed to amend the proviso to section 92C to provide that where more than 1 price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such price. However, if the arithmetical mean, so determined, is within five% of the transfer price, then the transfer price shall be treated as the arm's length price and no adjustment is required to be made.

This amendment will take effect from 1st October, 2009 and shall accordingly apply in relation to all cases in which pro-

ceedings are pending before the Transfer Pricing Officer (TPO) on or after such date.

Special provision for computing profits and gains of business on presumptive basis Section **44AD**

The existing provisions of the Income-tax Act provide for taxation of income on presumptive basis in the case of construction business, income from goods carriages and business of retail trade.

Section 44AD prescribes a method of presumptive taxation for assessees engaged in the business of civil construction or supply of labour for civil construction in which a sum equal to eight percent of the gross receipts is deemed to be the profits and gains from business. Section 44AE provides presumptive provisions for the assessees engaged in the business of plying, hiring or leasing upto 10 goods carriages in which a prescribed sum per vehicle is deemed to be the presumptive income of the assessee. Section 44AF prescribes a method of presumptive taxation for retail trade, under which the presumptive income is computed at the rate of a sum equal to five% of the total turnover.

There has been a substantial increase in small businesses with the growth of transport and communication and general growth of the economy. A large number of businesses and service providers in rural and urban areas who earn substantial income are outside the tax-net Introduction of presumptive tax provisions in respect of small businesses would help a number of small businesses to comply with the taxation provisions without consuming their time and resources A presumptive income scheme for small taxpayers lowers the compliance cost for such taxpayers and also reduces the administrative burden on the tax machinery.

In view of the above, it is proposed to expand the scope of presumptive taxation to all businesses by substituting a new section 44AD. The salient features of the proposed presumptive taxation scheme are as under:

(a) The scheme shall be applicable to individuals, HUFs and partnership firms excluding Limited liability partnership firms. It shall also not be applicable to an assessee who is availing deductions under sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA under the heading "C.-Deductions in respect of certain incomes" in the relevant assessment year.

(b) The scheme is applicable for any business (excluding a business already covered under Sec. 44AE) which has a maximum gross turnover /gross receipts of 40 lakhs.

(c) The presumptive rate of income is prescribed at 8% of gross turnover /gross receipts.

(d) An assessee opting for the above scheme shall be exempted from payment of advance tax related to such business under the current provisions of the Income-tax Act.

(e) An assessee opting for the above ssheme shall be exempted from maintenance of books of ac'counts related to such business as required under section 44AA of the Income-tax Act.

(g) An assessee with turnover below Rs 40 lakhs, who shows an income below the presumptive rate prescribed under these provisions, will, in case his total income exceeds the taxable limit, be required to maintain books of accounts and also get them audited.

(h) The existing section 44AF is proposed to be made inoperative for the assessment year beginning on or after 1st day of April, 2011.

The proposed amendment will take effect from 1st April, 2011 and will, accordingly, apply in relation to the assessment year 2011-12 and subsequent years'.

Taxation of Limited Liability Partnership (LLP)

The Limited Liability Partnership Act, 2008 has come into effect in 2009. LLP Rules (except some rules dealing with conversion) and forms have been notified w.e.f. 1st of April, 2009.

It is proposed to incorporate the taxation scheme of LLPs in the Income Tax Act on the same lines as the taxation scheme currently prevalent for general partnerships, i.e. taxation in the hands of the entity and exemption from tax in the hands of its partners. A "limited liability partnership" and a general partnership will be accorded the same tax treatment.

It is also proposed that the word 'partner' shall include within its meaning a partner of a limited liability partnership, the word 'firm' shall include within its meaning a limited liability partnership and the word 'partnership' shall include within its meaning a limited liability partnership as these terms have been defined in the Limited Liability Partnership Act, 2008.

The LLP Act provides for nomination of "designated partners" who have been given greater responsibility. It is proposed that the designated partner shall sign the income tax return of an LLP, or, where, for any unavoidable reason such designated partner is not able to sign the return or where there is no designated partner as such, any partner shall sign the return.

It is proposed to provide that in case of liquidation of an LLP, every partner will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part.

As an LLP and a general partnership is being treated as equivalent (except for recovery purposes) in the Act, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of section 45 shall apply.

It is further proposed to make the amendments effective from the 1st day of April 2010 i.e. assessment year 2010-11.

Conclusion

Summing up the write up on Direct Tax proposals, one gets a mixed feeling of some joy, some disappointment and some hope. Joy for abolishment of 10% surcharge on personal taxes and abolishment of Fringe Benefit Tax. Disappointment for continuation of 10% surcharge on company tax and also of 3% Education Cess on taxes of all categories. Hope for introduction of Direct Tax Code and reintroduction of SARAL for return of income.

Thi views expressed in this booklet are not necessarily those of the Forum of Free Enterprise

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good':

- Eugene Black

FORUM

of Free Enterprise

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