Latin Manharlal Securities Pvt Ltd

PRE-BUDGET EXPECTATIONS 2011-12

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Year 2010 was a good year for the world and especially for India. The world came out of recession and India regained its growth trajectory of high single digit growth despite facing one of the worst global recessions in last 100 years.

Now that the dust has settled to large extent, Governments across the world have decided to formulate policies that encourage financial stability and fiscal prudence. There are going to be big changes in financial sector including Indian financial sector. Banks have been in the middle of this and certainly they have expectation from the Government in order to enable them serve the financial needs of the common man and industries.

Since the previous Union Budget, the RBI increased the rate of interest 7 times to curb inflation and to arrest fiscal deficits. In a commitment towards controlling high double digit food inflation, FM might well unleash some crucial measures in this Budget including opening up of more procurement and distribution centers for food grains, promoting greater investment in agriculture infrastructure and increase expenditure on irrigation related projects to enhance overall farm sector productivity.

According to the rating agency Crisil, India's gross domestic product (GDP) is set to expand by 8.6% in 2010-11 and at a sustained annual average of 8.4% over 2010-11 to 2015-16 driven by domestic demand spurred by a growing young population, rising middle-class consumption and growing investment and savings. It also added that to attain 10% growth, India will have to remove supply side constraints and undertake structural reforms in infrastructure, agriculture and education and more private sector participation.

India's fiscal deficit from April'10 to Dec'10 was at ₹3.81 trillion ($83.08 billion), or 44.9% of the full-year target of ₹3,81,408 Crs. The Government of India (GoI) has targeted a fiscal deficit of 5.5% for FY11BE, 4.8% for FY12BE and 4.1% in FY13BE.

The fiscal situation of the GoI this year is expected to be under control. The fiscal deficit is likely to remain within the targeted level of under 5.5% of GDP during FY11 mainly because of proceeds from the 3G spectrum and broadband wireless access (BWA) auction, proceeds from disinvestment, better tax collections, and decontrol of petrol prices.

Total disinvestments proceeds from Central Public Sector Enterprises (CPSEs) public offers in the current fiscal stands at ₹22,763 Crs (as on 18th Feb'11) as against ₹40,000 Crs targeted for FY2011BE.

In the light of current political situation and the unearthing of scams has led to a drop in consumer confidence. We believe that GoI will try their best to regain the confidence by various populist measures. So overall, the budget is expected to be more populist and focused on keeping fine balance between growth and fiscal deficit.

TAXATION

Corporate Tax Rates

In order to remain globally competitive, it is suggested that the corporate tax rate be reduced from 30% to 25%. This will result in generating more surpluses in the hands of companies with the consequential impact on investments and growth. Tax rate for corporates be liberalized which has been a long pending corporate demand of the people.

Minimum Alternate Tax

The present rate of Minimum Alternate Tax (MAT) is 19.93%. The rate was 8.48% in FY01 and the rate has almost doubled in last 10 years. Therefore it is expected the rate of tax under MAT be reduced to 15%.

SECTORAL IMPACT

Agriculture & Fertilisers

- Thrust on rural development programmes (NREGA) to continue with sustained focus on irrigation projects.
- Likely to encourage investment in agriculture, cold storage chains and possible reduction in mandi tax.
- The government has already launched the National Food Security Mission (NFSM) in 2008, however the implementation of the mission on full swing should also be taken care
- Increase in fertiliser subsidy to absorb high global prices so that the domestic price of urea, Di-ammonium phosphate (DAP) and muriate of potash (MOP) are protected.
- The long-awaited move to bring urea under the Nutrient-Based Subsidy (NBS) scheme is likely to be announced and even the government would decontrol its prices gradually.

Automobiles

- Excise duty on 2-Wheelers, small cars (<1200 cc for petrol and <1500 cc for diesel engines), 3-Wheelers and Commercial vehicles likely to be remain untouched (was hiked from 8% to 10% in last budget). Society of Indian Automobile Manufacturers (SIAM) urges the GoI to retain the existing excise duty even though the industry has seen good growth. The automobile industry contributed 86% more excise to the GoI kitty than last year, accounting 26% of the overall excise kitty and there is no need to roll back to the levels of the pre-stimulus package days. Currently the auto industry is facing input cost pressure and interest rate hikes which may impact demand.
- Reduce excise duty and remove the additional ₹15,000 tax imposed on big cars to minimise the gap with those of small cars. Big cars, sports-utility vehicles (SUVs) and multi- utility vehicles (MUVs) currently attract 22% excise duty plus an additional tax of ₹15,000. Vehicles which are longer than 4 metres and above 1200 cc for petrol and 1500 cc for diesel engines are classified as big cars.
- Retain the current customs duty structure on imported cars in order to protect the domestic industry as well as to encourage manufacturing cars in India. Fully imported cars attract over 110% customs duty.
- Increase incentives for vehicles running on optional fuels.
- Special incentive for eco-friendly vehicles and the weighted deduction on R&D given in Budget 2010-11, extended for 10 years

Aviation

- Likely to review the levy of service tax and may consider to remove the upper limit on air travel. The ministry had put a cap on service tax in case of domestic flights at 10% of the gross value of the ticket, or ₹100 per travel, whichever is less, and on international travel by economy class at 10% of the gross value of the ticket, or ₹500, whichever is less.

Banking & Financial Institutions

- Raising FDI limit for insurance biz from current 26% to 49% **(+VE for HDFC, ICICI, SBI, RCAP, Aditya Birla Nuvo, Bajaj Finserve, ING Vysya, & Kotak Bank)**
- Allowing banks to raise money through infrastructure bonds which could hurt the prospects of NBFCs like PFC, REC and IDFC.
- Clarity on the norms and guidelines for issuing Banking licenses to industrial houses and non-banking financial corporations (NBFC) for setting new Banks.
- Incentivize banks to set up branches in rural areas. The Government has indicated on setting up a fund from which all banks can withdraw to fund some of their operations in rural areas.
- Allow Government owned insurance companies to raise money from capital market.
- Listing Norms for Insurance companies is likely.
- To reduce required paid up capital for health insurer to ₹50 crs (Currently the minimum capital required to enter insurance business - life or general - is ₹100 crs).
- At present, there is 3% interest subsidy available on farm loans, which enables banks to offer farm loans at 7%. There is an additional 2% subsidy for farmers who repay their installments on time, which translates into an annual cost of 5% for those with a clean track record. It is expected that the GoI will increase the interest subsidy on pump loan.

- Hike in limit of Refinance from IIFCL for commercial banks likely. IIFCL currently refinances 60% of commercial bank loans for PPP projects in critical sectors. For FY11E, IIFCL targeted to disburse ~₹6000 Crs.
- The Governments Borrowing Program would play a key in deciding the direction for interest rates and yields on government bonds. The government borrowings are expected to be lower than that of ₹4.47 trillion ($98 billion) of last year in order to contain the fiscal deficit at 4.8% of GDP in FY12E.
- Guidelines on creation of Infrastructure Debt Fund to meet the projected investment of $1 trillion required to sustain the country's economic growth rate in the 12th Five-Year Plan (2012-2017).

Capital Goods

- Exemption of anti dumping & safeguard duties on import of machinery under EPCG Scheme.
- Basic Customs Duty exemption on Capital Goods for Power Plants so as to reduce the cost of power generation.
- 100% CENVAT Credit on Capital Goods in year of purchase (earlier 50% CENVAT credit on capital goods can be availed in year of purchase and balance 50% in subsequent year)
- Demand to increase import Duties on power equipments for mega projects. However, since this escalates the costs of projects, it is unlikely to be implemented (If implemented it would be positive for L&T, BHEL, Thermax)

Cement

- Levying uniform rate of excise duty on cement. Current Excise Structure is as follows:

Cement Meant for clearance	Rate of duty
Having Retail Sale Price declared, not exceeding ₹190/- per bag of 50 kg or ₹3800 per tonne of cement.	₹290/- Per tonne.
Having Retail Sale Price declared exceeding ₹190/- per bag of 50 kg or ₹3800 per tonne of cement	10% of Retail Sale Price
Packed cement for industrial & institutional consumers & other than packed cement, i.e. loose cement	10% ad-valorem or ₹290/- Per Tonne whichever is higher.

- Abatement of 55%, as recommended by National Council of Applied Economic Research (NCAER) in their Report of 2005, be given to the Cement Industry on Excise Duty in order to avoid cascading effect on tax on trade margins and tax on tax.
- Import Duty on Coal, Pet Coke and Gypsum (currently 5%) be abolished to be in line with the established principle that Import Duty on Inputs should not be higher than on the finished product.
- Plant, machinery and equipment required for installing Waste Heat Recovery System (WHRS) may be given full exemption from - Customs Duty, CVD, SAD, Excise Duty, Service Tax incurred during the construction period of the project, Central Sales Tax, and State Governments be advised to give exemption/concession on VAT.
- VAT on Cement and Clinker be brought down to 4% (currently 12.5%) in line with Steel and Cement be included in the Declared Goods.
- Restoration of 4% excise duty on asbestos cement roofing sheets, pipes and allied products from current 10%.
- Deduction of income under section 80-IA of the Act to be extended to Cement Industry.

Construction & Real Estate

- Increased allocation towards Jawaharlal Nehru National Urban Renewal Mission (JNURM), National Highway Development Program (NHDP), Accelerated Irrigation Benefit programme (AIBP) and Bharat Nirman program.
- Introduce Goods and Services Tax (GST) and include the Real Estate sector under the ambit of this single tax regime. This will simplify transaction costs (which currently include stamp duty) and give developers a set-off or credit on the taxes paid on construction material and services.
- More sops for affordable housing under 'Housing For All' – In Last budget, housing loans under ₹10 lakh were given an interest rate cut of 1% and similar measures are expected this time too.
- Increase in tax exemption limit on interest and principal payments on housing loans and rental income.

- Providing more incentives to Real Estate Mutual Funds (REMFs) to support the housing sector.
- Special Residential Zones (SRZs) should be taken off the drawing board and finally implemented, and developers who focus on ultra-low-cost housing through SRZs should be given more sops.
- Likely to bring some differentiation between affordable housing, mid housing and high luxury segment. The GoI could consider tax holiday benefits under Section 80IB (10) for affordable housing projects.
- An increase in the cap on tax deduction available on housing loans is also likely.

FMCG & RETAIL

- Increase in personal income tax exemption limits resulting higher disposable incomes in the hands of consumer to drive overall demand
- Structural changes in excise duty on tobacco products and excise duty on Cigarettes may increase (varying rates depending upon the length and type of cigarettes)
- No change in Cenvat rate (currently at 10%) considering the high inflation and rising input prices
- Increase in service tax from 10% to 12% is also likely.
- Roadmap for FDI in retail sector and implementation of DTC and GST expected to be touched upon this time.

IT & ITES

- Continuance of tax holiday for another year till FY2012 for Software Technology Parks (STP) / Export Oriented Undertakings (EOUs) units given the fact that, under Direct Tax Code to be introduced from 1st April 2012, tax holiday for STP/EOU units will be withdrawn.
- Units located in STP are subject to pay MAT which has been constantly rising (currently at 19.93%) and impacting their cash flows. Though MAT credit is allowed to be carried forward and set off over a span of 10 years, an uncertainty exists on availability of such MAT credit under the DTC.
- Transparency needed on the legal rights of the companies who have substantial MAT credits accumulated over the years, will still avail the MAT Credit facility under the DTC.
- Currently, units located in SEZs are exempted from paying MAT and DDT. Clarity on exemption of MAT and DDT for SEZ units, under the DTC - Under the current tax provisions, SEZ units are exempted from payment of MAT and DDT and the DTC Bill does not exempt SEZ Units from the payment of MAT and DDT.

Media

- Relaxation in FDI norms - Increase in FDI limits from currently 49% in DTH and Cable to 74%, 26% in News broadcasting & Print media to 49% and 20% in Radio sector to 49%.
- Reduction in duty on set-top boxes is also likely
- Reduction in service tax - Broadcasters are subject to levy of service tax @12.24% unlike Print media companies.

Metals & Mining

- Increase in import duty on HR coil from 5% to 10%
- Increase in import duty on ferro alloys from 5% to 7.5%
- Import Duty on pig iron to be reverted to Nil.
- Basic customs duty on Copper Concentrate (ITC HS Code 26.03) to be reduced from 2% to Nil.
- To Correct the Inverse Duty structure on ferro vanadium and its raw material vanadium pentoxide. It is expected that the Customs Duty on Vanadium Pentoxide (Chapter Heading 2825 30) and Vanadium sludge / Ammonium Metavanadate (Chapter Heading 2841.90) be reduced to NIL from the present level of 7.5%.
- Increase the custom duty on ferro alloys from 5% to 7.5% except Ferro Nickel
- Waive custom duty on raw materials i.e Ores (ie. Manganese Ore, Chrome Ore, Molybdenum Ore/Moly Oxide, Tungsten Ore, Wolframite Ore, Scheelite Ore, Nickel Oxide, Vanadium ore, etc) for production of Ferro Alloys
- Uniform 20% export duty on all classes of iron ore (fines and lumps)

Oil & Gas

- Tax holiday to be extended to the profit from production of natural gas produced in any block whether awarded under NELP-I to NELP-VII or CBM and should be available retrospectively to all Oil & Gas E&P companies.
- Extension of tax holiday for E&P of natural gas from blocks licensed under NELP-IX.
- Tax Holiday u/s 80-IB(9) available to exploration and production (E&P) companies for 7 years from the year of commercial production be extended to 10 years.
- Reduction of excise levies on diesel and central levies on petrol which was increased by ₹1 per litre each to ₹4.60 and ₹14.35 a litre respectively in last budget.
- Customs duty on crude oil to be reduced to NIL from current 5% due to rising crude oil prices and increasing under-recoveries of OMCs.
- E&P operators be permitted to select a continuous 10 year period for tax holiday at any time out of the first 15 years period following the commencement of commercial production. This logic is already accepted for other infrastructure projects viz. power, roads, telecommunications, ports, airports, water supply etc. that have similar large capex requirements.
- All E&P income should be exempted from MAT as under section 42 of the act, revenue as well as capital expense is fully allowed to be deducted starting with the year of commercial production. The expenditure debited in the books in the initial years is however much lower, resulting in much higher book profits. The "MAT" therefore takes away what the "Section 42" provides - negating the NELP philosophy, and diluting tax exemption.
- 100% depreciation be permitted in the first year on capex of items to be abandoned or Balancing depreciation be permitted in the last year of operation to fully depreciate such capex items. The upstream industry spends significant money to explore and develop the wells. However they are granted a limited period for extraction. In the given scenario, to the extent expenditure is not allowable u/s. 42, only depreciation allowance is being granted.
- Diesel De-regulation likely.

Power & Power Ancillary

- Removal of Withholding tax on overseas investments.
- Subsidized interest on loans taken by state electricity boards (SEBs) to cut distribution losses
- Continued thrust to schemes like R-APDRP & RGGVY with greater emphasis on reducing T&D losses & village electrification.
- Formation of a debt fund to raise low-cost long-term resources to re-finance power projects.
- Fiscal benefits available under section 80-IA to power projects should be extended further instead of March 31st 2011 at present.
- As per the provision of section 80-IA(4)(iv) of the Act, profit earned by an undertaking is exempted if it begins to generate power up to March 31, 2011. This exemption is expected to extend by a year upto March 31, 2012.
- Demand to increase import Duties on power equipments for mega projects. However, since this escalates the costs of projects, it is unlikely to be implemented. (If implemented it would be positive for L&T, BHEL, Thermax)
- Reduction in import duty on thermal coal from current 5%.

Pharmaceuticals

- 200% weighted deduction on R&D should be extended to standalone R&D and outsourcing.
- To align the excise duty rates of Active Pharmaceutical Ingredients (APIs) with that of the finished formulations or provide for a refund mechanism for the unutilised Cenvat Credit. The generic excise duty rate on the APIs presently is 10.3% vs. 4.12% on the generic excise duty rate on finished formulations.
- Current abatement of 35% on Maximum Retail Price (MRP) allowed for the purpose of levying excise duty on Pharmaceuticals should be increased as it's not sufficient to cover the R&D costs and trade margins. Hence an abatement of 45-50% is expected to enable Pharma industry to cover its costs while calculating the excise duty payable.
- Expenses incurred outside R&D facility like those on overseas trials, preparations of dossiers, consulting & legal fees, ANDAs should be eligible for weighted deduction.
- Foreign Direct Investment (FDI) cap may be reduced to 49% from current 100%.
- Higher tax depreciation on plant & machinery used for hospital and medical diagnostics also expected.

Telecom

- Relaxation in the taxation norms to telecom service providers and telecom infrastructure companies, given the capital intensive nature of the industry.
- Expected to impose import duty on imported mobile handsets to encourage the domestic production.
- Industry demands to make 3G investment (capex + auction fees) to eligible for 80-I benefits which will benefit all 3G license operators.

Travel & Tourism

- Hotels be given infrastructure status and be included under section 80 IA **(+VE for hotel industry)**
- Section 32 of the IT Act be amended to restore the depreciation rate to 20% for hotels. Further, the additional depreciation applicable to Plant & Machinery under section 32(1)(iia) should also be allowed to hotels which have to make heavy investments in hotel buildings.

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