



BMR Advisors

Tax and Regulatory

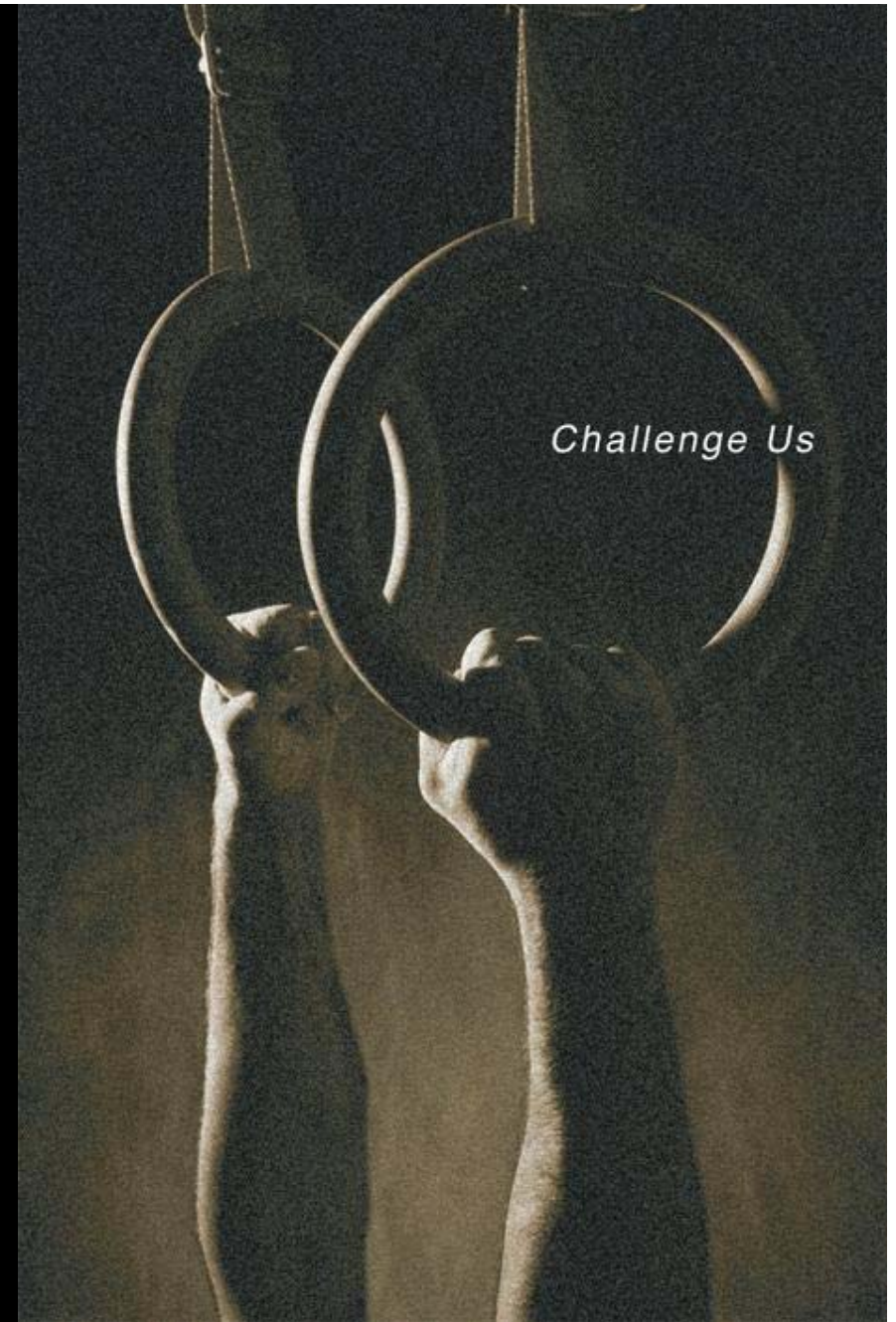
INDIA BUDGET 2007

RUN UP, OUTLOOK AND
EXPECTATIONS

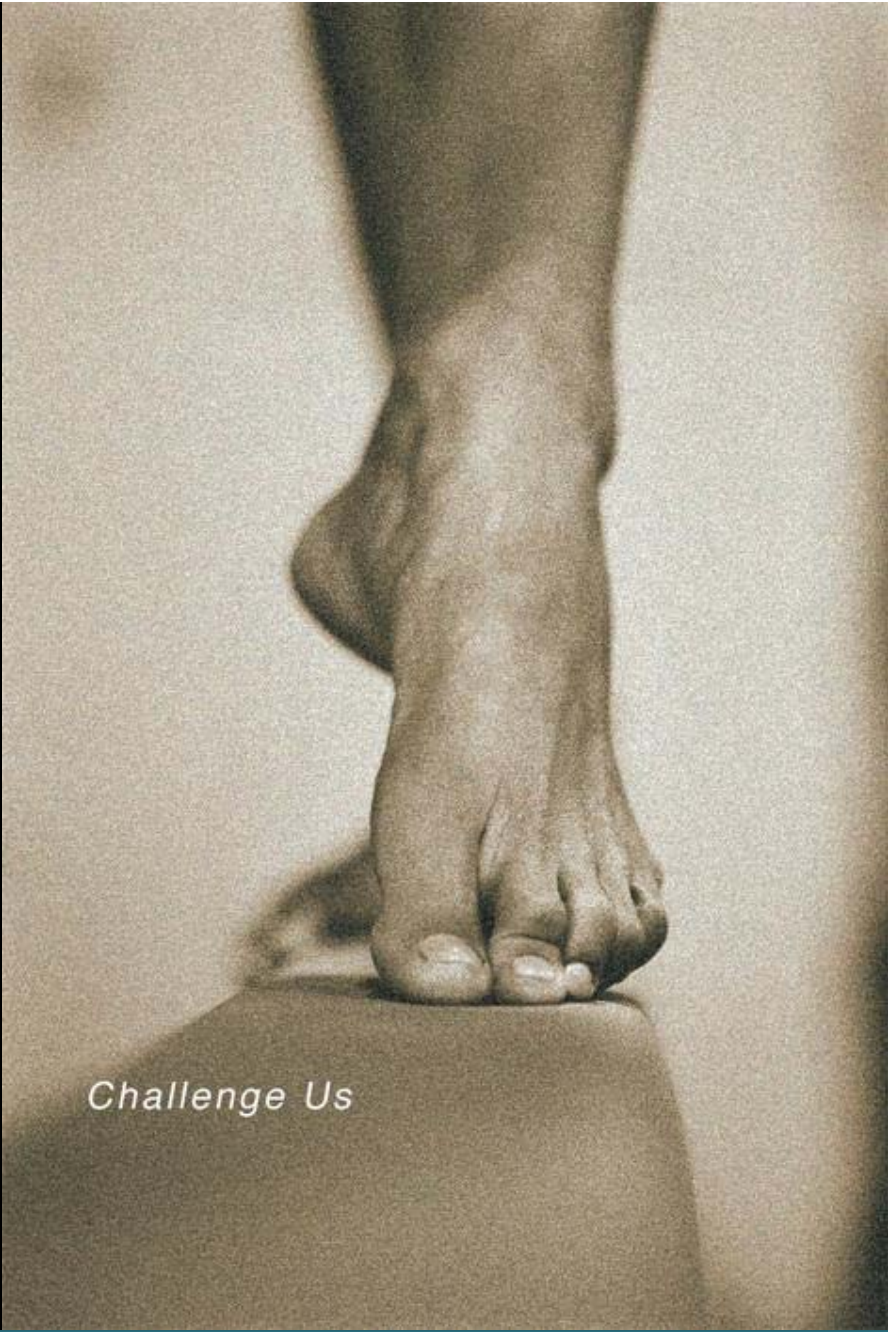
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CONTENTS

- Run up to the budget
- Indian economy outlook
- Industry wishlist
- BMR expectations – Direct tax
- BMR expectations – Indirect tax
- Significant policy issues
- Summary & conclusion



RUN UP TO THE BUDGET



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RUN UP TO THE BUDGET

- India on sustained growth path: *IMF*
- Significant improvement in states' fiscal position: *RBI*
- Markets upbeat on Q3 corporate results
- Finance Ministry and Planning Commission row over hike in social sector allocations
- Are Special Economic Zones sustainable – Growth vs tax sops
- Tax exemptions to go: *PM*
- India Inc's effective tax rate only 17 percent – MoF; industry claims it is 41.82 percent
- **“India overheats” – *The Economist*, February 3-9, 2007**

(Source: *Press reports, Publications from IMF, RBI, BMR Research*)

RUN UP TO THE BUDGET

- FDI in insurance may be raised to 49 percent from current 26 percent
- Government may liberalize FDI in retail sector
- IT ministry appeals to extend tax holiday for IT industry
- Ordinance promulgated on National Tax Tribunal Act, 2005 – controversial aspects tackled
- New income tax code unlikely; framework and direction for new code possible
- Surcharge on corporate, personal income tax likely to go
- Increase in education cess to create a corpus for loans to low-income family students

(Source: *Press reports, BMR research*)

RUN UP TO THE BUDGET

- Duty slash on cement, capital goods to check inflation - Government to lose INR 30 billion
- States may levy 4 percent VAT on imports
- Consolidation of CENVAT rate at 16 percent
- Ministry of Petroleum for removal of CENVAT on diesel
- Reduction of basic customs duty to 10 percent
- Service tax rate may go up to 14 percent
- More services to come under service tax net
- Customs duty on auto components could reduce to 7 percent
- Central Sales Tax rationalization
- Taxation of services at the State level

(Source: *Press reports, BMR research*)

SCORECARD

	Quick Estimates * (FY 2005-06)	Advanced Estimates ** (FY 2006-07)	Score
Growth indicators (in percentage)			
GDP	9.0	9.2	😊
Manufacturing	9.1	11.3	😊
Agriculture	6.0	2.7	😞
Services	9.8	10.3	😊

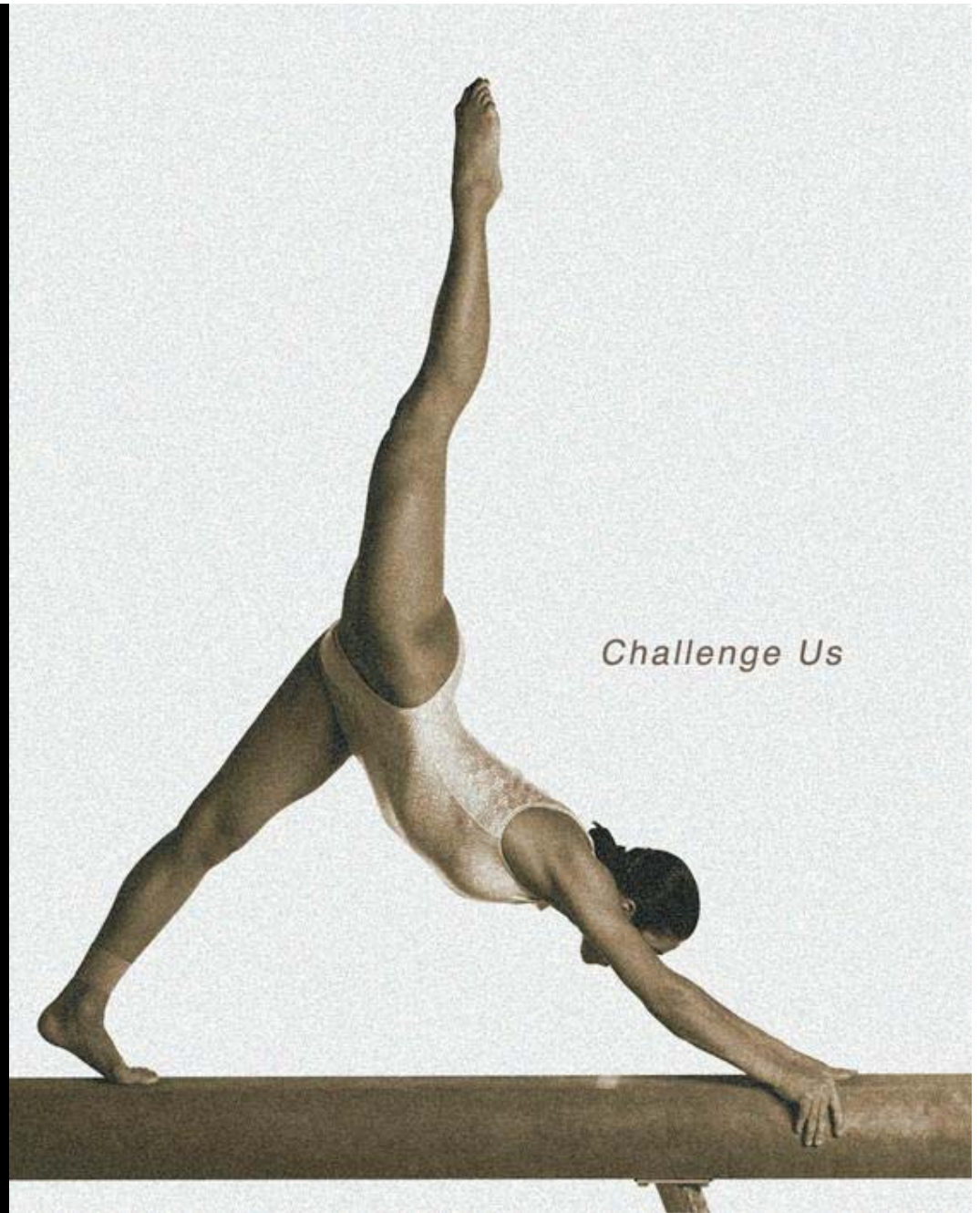
Other indicators (in percentage)			
Inflation	4.02***	6.58	😞
Gross tax/GDP	10.5	10-12	😊

* CSO Quick Estimates – January 31, 2007

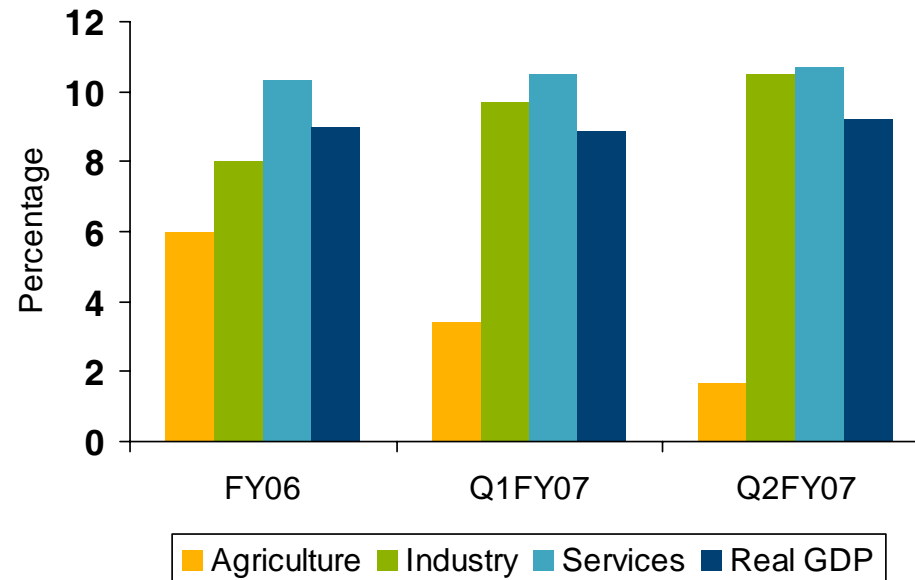
** CSO Advanced estimates – February 7, 2007

*** Budget Highlights – February 28, 2006

INDIAN ECONOMY OUTLOOK



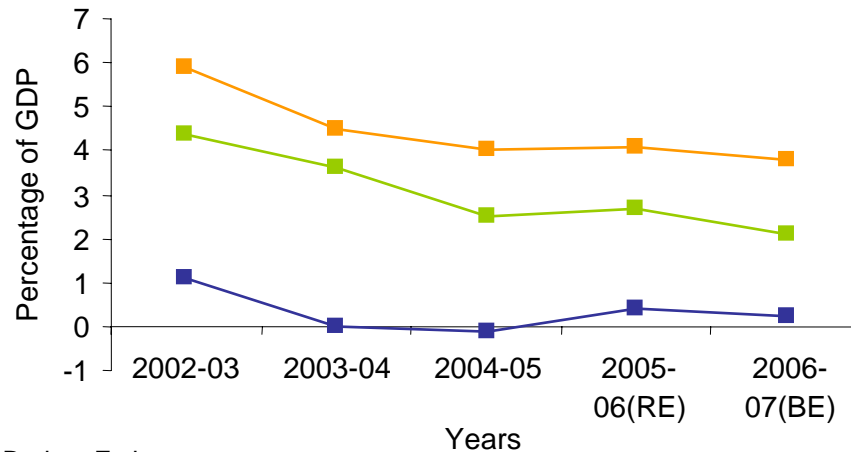
GDP GROWTH PATTERN IN 06-07



Source: CSO Quarterly estimates of GDP for the third quarter

- GDP growth at 9.2 percent for Q2 (9.1 percent for Q1) - **highest ever growth rate registered**
- Agricultural growth decelerated at 1.7 percent
- Industry growth - 10.6 percent
 - Cement and steel stood out
- Services sector - steady double digit growth

PUBLIC FINANCE



BE - Budget Estimates
RE - Revised Estimates

■ Primary Deficit ■ Revenue Deficit ■ Gross Fiscal Deficit

Source: RBI Mid-term Review 2006-07

India's public deficit one of the highest in the world –

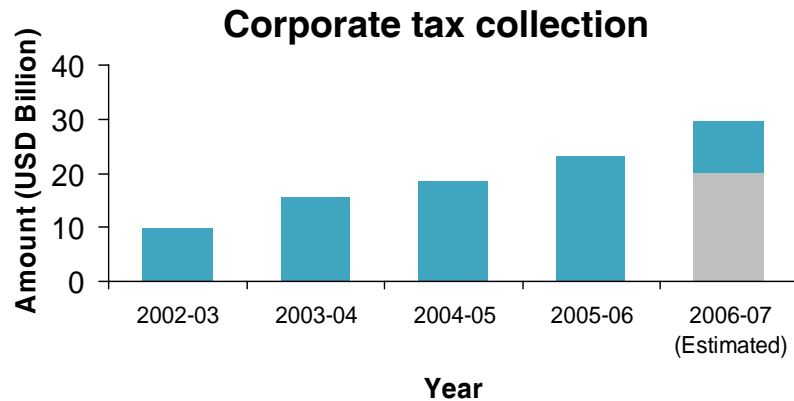
WEF Global Competitiveness Report 2006-07

*On track to meet **FRBM** targets for 2006-07*

➤ How the Q2 numbers stack up:

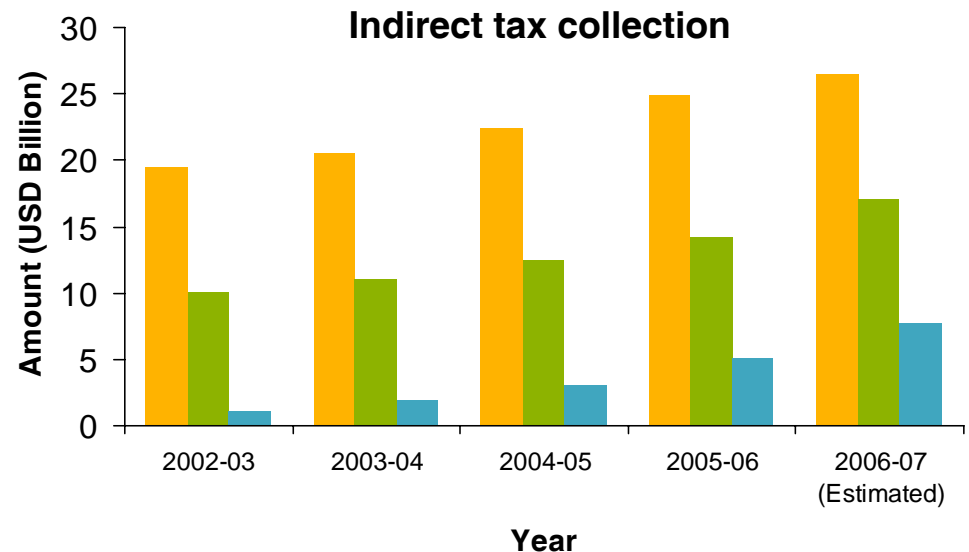
- Fiscal deficit of USD 24 billion is over 72% of budget target (for FY 2006-07)
- Aggregate expenditure higher, rise in revenue expenditure, decline in capital expenditure
- Rise in non-plan expenditure by 16.3 percent

BUOYANT TAX REVENUES



- Corporate tax collections increased by 53 percent
- Growth rate of tax revenues for all taxes has exceeded targets

- Tax to GDP ratio around 10-12 percent – a challenge
- Revenue surplus of USD 8 billion expected in 2006-07



(Source: www.indiabudget.nic.in; Press reports)

WHAT IS DRIVING CORPORATE GROWTH?

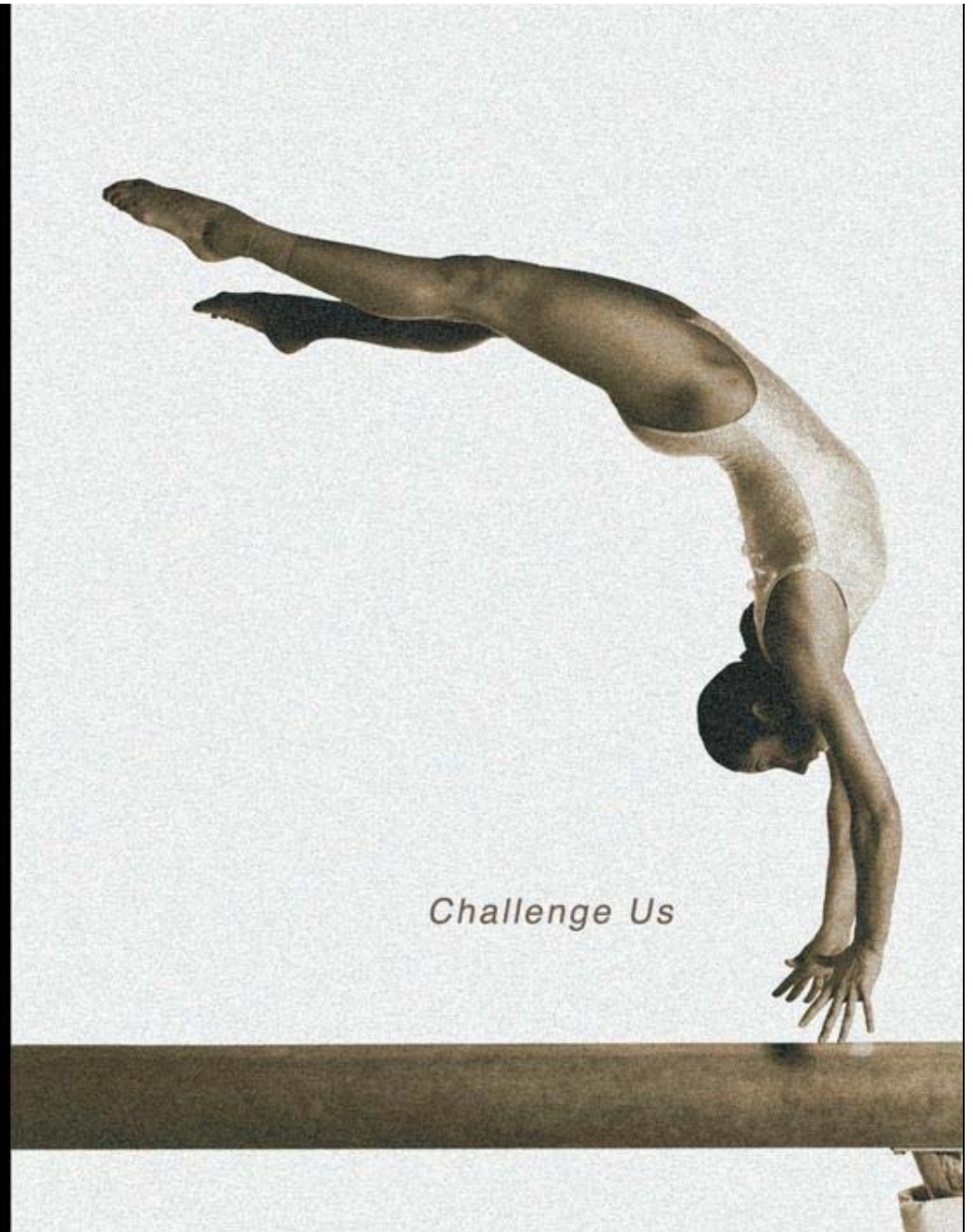
- IT exports expected to grow to USD 62 billion in 2008 and USD 148 billion by 2012
- Growth in construction up by 9.8 percent in Q2 and 9.5 percent in Q1 over 2005-06
- NSE and BSE ranked **third** and **fifth** in the world by number of transactions
- **Demographic dividend**
 - 50 percent of population under 25 – **youngest labor force in the world**
 - 40% of the population of working age
- **Organized retail expected to cross USD 21 billion** from current size of 7.5 by 2010
- Portfolio investment flows over last two years – USD 20 billion
- **India (USD 1.24 billion) topped the PE investment ranking** in 2007 leaving behind China (USD 609 million) and Japan (USD 980 million) – ranked among top 10 PE destinations in 2006

(Source: *Press reports, Publications from RBI, CSO, IBEF, BMR Research*)

WHAT COULD IMPACT GROWTH?

- 9 percent growth rate in three consecutive quarters - *will the party continue?*
 - RBI forecasted 8.5-9 percent, CRISIL, NCAER predicted 8.2 - 8.3 percent
 - IMF predicts 7.3 percent for 2007
- Diminishing agricultural growth - *pressure on rural economy*
- Fifth largest stock of foreign exchange reserves amongst the emerging market economies - *Are we deploying our reserves?*
- Infrastructure spend / GDP at 5 percent – compared to **China's 9 percent** *“Perhaps the only thing really growing faster in India than China is hype” – The Economist, February 3-9, 2007*
- Recent inflation trend is cause of worry – RBI hiked repo rate by 25 bps on January 31, 2007
- Stability of interest rates
- Employment generation for 71 million additional persons in next five years – *Demographic dividend or demographic liability?*

INDUSTRY WISHLIST



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WHAT DO CAPTAINS OF INDUSTRY WISH?

- Incentivise savings for infrastructure projects
- Privatization of Government undertakings
- Increase in expenditure efficiency, productivity, reduction in subsidies
- Increase in FDI for insurance to 49 percent from current 26 percent
- Liberalization of FDI in retail sector

(Source: CII, FICCI, ASSOCHAM)

WHAT DO CAPTAINS OF INDUSTRY WISH?

- Administrative reforms in tax controversy
- Reduction of corporate tax rate to 25 percent and surcharge to 2.5 percent
- Reduction in MAT to 7.5 percent
- STT to form part of cost of acquisition of securities
- Abolishment of BCTT
- Genuine business expenses be made outside the purview of FBT
- Payment of FBT should be allowed as a business deduction
- Restoration of depreciation on plant and machinery to 25 percent
- Increase in threshold limit of savings to INR 0.2 million

(Source: CII, FICCI, ASSOCHAM)

WHAT DO CAPTAINS OF INDUSTRY WISH?

- Extension of software technology park sops
- Tax breaks for investments in R&D
- Single levy regime for telecom service providers: COAI
- Phase out of cross subsidies in pricing of oil and electricity
- Tax holiday for LNG projects, cross-country pipelines
- Rationalization of duty structure for electronics and hardware sector
- Infrastructure status for hospitality industry

(Source: CII, FICCI, ASSOCHAM)

DIRECT TAX EXPECTATIONS

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DIRECT TAX EXPECTATIONS

- Moderation of corporate and personal tax rates/surcharge
- Education cess rate likely to be increased
- **Road map for tax holidays**
 - Infrastructure and technology developing industries may get a boost
 - IT/ITES industry may get a fresh lease beyond 2009
 - Tax holidays on set-up of industrial units, real estate developers may face the axe
 - Imposition of sunset clause on open-ended exemptions likely
- MAT, DDT rate unlikely to change
- FBT likely to stay; may be rationalized
- E&P activities, LNG gasification and gas pipeline projects could get infrastructure status
- Liberal tax neutral business reorganization provisions to cover services
- FII taxation may be streamlined

DIRECT TAX EXPECTATIONS

- Policy framework for outbound investments by Indian corporates; possibly tax incentive
- Impetus to export sector likely to be provided through tax incentives
- Tax sops for biotech and pharma sector likely
- Simplification of tax structure for telecom companies likely
- Incentive to foreign companies setting-up Indian headquarters likely
- Expansion in scope of collecting information through Annual Information Return likely
- Tax break norms for Provident funds could be revisited
- Government likely to unveil the roadmap for EET
- Small savings instrument tax breaks likely to be reviewed to fund pension scheme for unorganised sector

INDIRECT TAX EXPECTATIONS



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INDIRECT TAX EXPECTATIONS

Customs

- Reduction of customs duty to 10 percent
- Enlarging the credit scheme for 'Additional duty in lieu of Sales Tax / VAT
- Continuing focus on Free Trade Agreements and relate provisions

CENVAT

- Possible move to further align rates into 3 bands
- Rationalisation of CENVAT credit scheme across goods and services
- Area based exemption may incorporate anti-abuse and anti-migration provisions

INDIRECT TAX EXPECTATIONS

Service tax

- Separate enactment may not be pronounced yet
- Expanding the list of services liable to service tax
- Possible increase in rates to 14 percent
- Threshold exemption for small service providers likely to be increased
- A composition scheme for service tax, without input credit may be tried for mid sized tax payers
- CENVAT credit scheme likely to see some rationalization and changes
- Amendments and clarifications for Export of Service and Import of Services rules
- Delegation of Service tax on select services by the states

CST

- Phase out of CST by 2010, reduction in CST rate in the Budget to 2-3 percent

INDIRECT TAX EXPECTATIONS

GST implementation

- To meet 2010 deadline, integration with State level VAT to be addressed
- Framework and overall legislative process
- Specific timelines should be articulated
- Inter-state credit mechanism should be evolved
- Harmonization of processes and compliance provisions
- Consistency of policy on existing incentives at State levels

SIGNIFICANT POLICY ISSUES



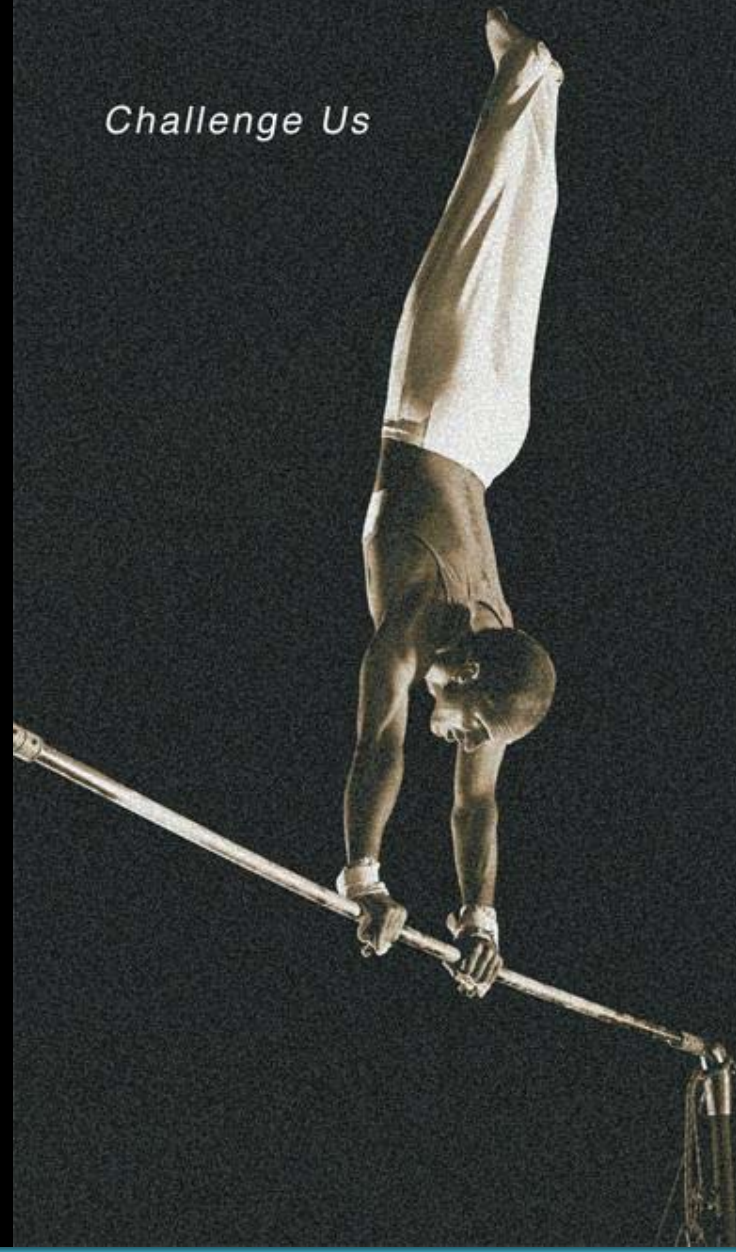
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SIGNIFICANT POLICY ISSUES

- FDI in retail, insurance
- Status of National Tax Tribunal
- **Special Economic Zones**
 - SEZ policy remains widely debated
 - Changes and uncertainties have delayed implementation
 - Procedural changes expected in Customs, CENVAT and Service tax
 - Anti-abuse provisions likely
- **New Income tax Code**
 - Proposed to be introduced (**ambitious!**)
 - Simplification and rationalization of tax procedures
 - Accountability of Revenue officers
 - Global best practice for depreciation
 - Incentive for Indian companies to become global
- Mechanics of entry tax at State level to be carefully evolved

SUMMARY & CONCLUSION

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SUMMARY & CONCLUSION

- Robust GDP and sectoral growth numbers, sans agriculture
- Growing domestic demand, savings and consumption
- Inflation, interest rate movements, capacity shortage – Is a hard landing on the horizon?
- Tax revenue buoyancy to continue
- Income tax holidays under review
- SEZ policy debate would continue
- New tax code framework to evolve
- Budget with an eye on 2009 general elections



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GLOSSARY

AGM	Annual General Meeting
ASSOCHAM	Associated Chambers of Commerce
BCCT	Banking Cash Transaction Tax
BSE	The Stock Exchange, Mumbai
CENVAT	Central Value Added Tax
CII	Confederation of Indian Industry
COAI	Cellular Operators Association of India
CSO	Central Statistical Organization
CST	Central Sales Tax
DDT	Dividend Distribution Tax
E&P	Exploration and Production
EET	Exempt Exempt Tax (taxation regime)
FDI	Foreign Direct Investment
FICCI	Federation of Indian Chambers of Commerce and Industry
FRBM	Fiscal Responsibility and Budget Management Act
GDP	Gross Domestic Product
GST	Goods and Services Tax
IBEF	Indian Brand Equity Foundation

IMF	International Monetary Fund
IPO	Initial Public Offer
IT	Information Technology
LNG	Liquefied Natural Gas
M&M	Mahindra & Mahindra Limited
MAT	Minimum Alternate Tax
MoF	Ministry of Finance
NCAER	National Council of Applied Economic Research
NSE	National Stock Exchange
ONGC	Oil and Natural Gas Corporation
PM	Dr Manmohan Singh, Prime Minister, India
R&D	Research & Development
RBI	Reserve Bank of India
SEZ	Special Economic Zone
STT	Securities Transaction Tax
USD	US Dollar
VAT	Value Added Tax
WEF	World Economic Forum

DISCLAIMER

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