The run up to Budget

- Ahead of Parliament elections, wooing weaker section of the society will be the prime objective. That means, sops to rural, agriculture and social sectors that encompasses the mass vote bank for all political parties.
- Ironically, this political compulsion does make a very strong economic sense in the form of inclusive growth and generation of purchasing power at the bottom of the pyramid. So in our opinion the Bottom Up leg of our twin engines of growth is getting priority over the Top Down leg in this budget.
- On taxation front we do not expect any harsh stand for any sections of the society. But they are likely to tinker with a positive bias on taxes that have impact on the weaker and lower middle classes.
- The sectors that could benefit are, once again ironically, are the same sectors that are today in the hot pan of fund managers. These are power, infrastructure, education, health service, capital goods, consumer goods, communication, transport etc.

Status quo to be maintained before and after the budget as there is nothing new or surprising proposal in the budget that could change the current market perception.

Expected positive rub off in FY 09 BE

- Personal Income Tax: Base limit will be raised from current Rs. 110,000.
    - Tampering with surcharge is most likely
    - Corporate Tax: Some reduction in current surcharge of 10%.
    - Cut in dividend distribution tax possibility from current 15%.
- Sharp increase in rural, agriculture and social sector spending.
- Rural delivery system for sops will be revamped to ensure direct reach of compensation to the beneficiaries by using post office and rural regional banks.
- Infrastructure funding institutions such as IDFC, IIFC, PFC etc., may be permitted to issue long term bonds in rupee as well as foreign currency.
- Tax free or SLR status long term bonds from certain institutions is possible.
- Rationalization of MAT with inclusion of hitherto tax exempted trusts.
- Further rationalization of VAT

Fiscal Performance in FY 08

Primary balance should show a small deficit unlike a small surplus last fiscal, mainly on account of higher interest pay out on huge outstanding MSS generated in the process of sterilizing the rupee surplus backed by unexpectedly higher inflow of US dollars.

- Tax Revenue collection to be 25% over Budget Estimate.
- Plan expenditure to increase to 4.5% of GDP (4.2%).
- Total Expenditure to increase by 22% and it will constitute 15% of GDP (14%).

	Budgeted	Expected
Fiscal Deficit	3.3%	3.0%
Revenue Deficit	1.5%	0.8%
Primary Balance	+ 0.2%	- 0.6%

Fresh Central Government borrowing in FY08 at Rs. 1095 bn, same as the Budgeted for FY08.

B&K Budget Expectations FY09

Fiscal Expectations

- Primary Balance target to be back in Surplus.
- Revenue Deficit target to be below 0.7% of GDP.
- Fiscal Deficit to be targeted below 2.8% of GDP.

- Fresh Central Government borrowing may be contained at the same level as FY08 near Rs. 1095 bn.
- Planned Expenditure under capital account will get a boost – over 50% higher.
- To target over 18% growth on total Tax Revenue.
- Income Tax collection to target 25% growth.
- Target growth for Total Expenditure to be over 20%.

Thrust Areas

Rural Initiatives will get major boost

Others:

- Power
- Water
- Transportation
- Communication
- Education
- Health
- Tax rationalization

Direct Tax Expectations

- Personal Income Tax: Base limit will be raised from current Rs. 110,000
- Tampering with surcharge is most likely
- Corporate Tax: A couple of point reduction in current surcharge of 10%.
- Possibility of reduction in dividend distribution tax from current 15%
- Rationalization of MAT with inclusion of hitherto tax exempted trusts

Indirect Tax Expectations

- Further rationalization of VAT
- Excise Duty on power equipment and other inputs to the power sector may be cut from 16% to 8%
- Excise duty exemption for all the 354 drugs specified in the National List of Essential Medicines and reduction of excise duty to 8%
- Reduction in excise duty on buses from 24% to 16%
- Increase in Export tax on iron ore

Policy Expectations

- Plans to boost agricultural production, that has been nearly stagnant through this decade. That will involve very large increase in allocation to Irrigation and conservation of water.
- Rural Infrastructure Development Fund Is expected to get additional allocation.
- Primary health system will receive a boost, including face lift for existing primary health centers and increase in manpower.
- Education allocation will be enhanced with thrust to hitherto unreached rural areas.
- Sharp increase in seats for higher and professional education to accommodate reservation in higher education.
- Rural delivery system will be revamped to ensure sops and compensation reach direct to the beneficiaries, by using post office and rural regional banks.
- Infrastructure funding institutions such as IDFC, IIFC, PFC etc., may be permitted to issue long term bonds in rupee as well as foreign currency.
- Tax free/SLR status for certain Infrastructure and long term bonds

Banking sector

- Emphasis on increasing the institutional finance for housing for poor through interest subsidy to Commercial Banks and Housing Finance Companies.
- Further reduction in risk weights on educational loans from 100% to 75% as education expected to remain a priority in forthcoming budget
- Interest earned on long-term lending to infrastructure industries to be exempted from income tax
- Increase in interest subvention on farm loans, from present 2%, to 3-4% as cost of funds still remains higher for banks,

Power

- 80IA Tax holiday may be extended for UMPPs till 2017
- ECB norms to be eased for the entire power sector and also for PFC & REC institutions to enable mobilisation of funds from abroad.
- Cut in excise duty on power equipment and other inputs from 16% now to 8%

IT sector

- Extension of tax benefits provided under section 10A/B to IT/ITes companies beyond FY09

Real Estate sector

- Conducive policy framework for REITs and REMFs and income tax benefits on the lines for mutual Funds.
- Reduction in certain duties of core building material.

Pharma

- Extend benefits of tax deduction for R&D activities to independent R&D divisions and raise the benefit to 200% (150%)
- Excise duty exemption for all the 354 drugs specified in the National List of Essential Medicines and reduction of excise duty to 8%
- Reduction in custom duty charges on life saving drugs

Cement

- Rationalization of excise duty to eliminate confusion over the present four tier system

Automobiles

- Reduction in excise duty on buses from 24% to 16%

Auto components

- No reduction in customs duty on components

Aviation

- Rationalisation of levies and duties on Aviation Turbine Fuel (ATF)

Metals

- Imposition of royalty as a percentage of sales on iron ore (to the extent of 6-7%)
- Increase in Export tax on iron ore

Expectations of Industry

Banking sector

- Tax incentives on M&As to be broadened to cover voluntary takeovers by private banks, foreign banks and even urban cooperative banks
- Banks want their investments in company shares and debentures, loans and guarantees given to corporate as part of normal business activities, to be excluded from transfer pricing norms. An exemption will allow banks to claim the tax benefits available on such expenditure
- To increase the ceiling for tax deduction at source as performed by banks or exempt banks from deduction of tax at source as the huge volumes of TDS certificates cause considerable inconvenience

Power

- 80IA Tax holiday may be extended for UMPPs till 2017
- Excise Duty on power equipment and other inputs may be cut from 16% now to 8%
- CVD on import of equipment for power projects may be cut to 8%
- Power and transmission projects not associated with UMPPs may have uniform duty structure of 5% basic duty & 8% CVD
- Transmission Cos associated with UMPPs may be exempt from paying Customs duty of 5-15% on equipment imports
- **Power Ministry Proposals**
  - Tax-free power bonds
  - Including Power in priority lending for banks
  - ECB norms to be eased for the entire power sector and also for PFC & REC institutions to enable mobilisation of cheap funds from abroad
  - Dividend & capital gains exemption to VC funds: reinstatement of benefits to power sector VCs and PE funds, which would mean full exemption on income as per the provisions of Section 10 (23) (FB)

Insurance

- To amend insurance laws relating to raising FDI from 26% to 49%
- Life insurance companies want the introduction of a separate limit of Rs 1 lakh per annum income tax exemption for long-term financial savings instruments under Section 80C of the Finance Act.
- Life insurers have proposed that they be allowed to float ULIP infrastructure bonds to raise long-term resources for the core sector.
- Allow insurance companies to carry forward losses for 12 years from current eight years.

Paints

- Softening of interest rates on housing loans and thrust upon affordable housing
- Tax sops/rationalization for real estate industry

Telecom

- Access deficit charge (ADC) should be abolished, and any assistance required by any operator should be provided through USOF.
- Revenue sharing license fee: License fees include contribution to Universal Services Obligation Fund (USOF), 5% of AGR. The license fee should be reduced from the current levels, of 6% to 10% of AGR, to a uniform 6%.
- Spectrum charge: Government should maintain the spectrum charge from the current level of 2%-6% of AGR, and avoid any one time entry fee for any spectrum allocation.
- All applicable fees should be combined into a single Unified Fee

Section 80- IA

- Exemption on taxable profits should be extended to 10 years, compared to existing period of 5 years right now.
- This above tax holiday has been withdrawn for company transferred in a scheme of merger or demerger after 31 March 2007, effective 01 April 2008.

Aviation

- Extension of 72A benefits (carry forward of losses and unabsorbed depreciation on merger) to private airlines

Healthcare

- Easy funding for the healthcare sector through
  - Providing infrastructure status to the sector so that long term loans can be raised from banks
  - Automatic route for dollar based loans for hospital funding including land funding through ECBs/FCCBs
- Income tax holidays for hospitals under section 80 I (A)

Oil & Gas

- Removal of service tax on exploration services
- Removal of customs duty on imported LNG
- Rationalization of Excise duty structure on sensitive petroleum products
- ‘Declared good’ status for ATF leading to uniform VAT rate of 4%

Retail

- Grant of Industry status to provide for greater access to funds and transparency in the system
- Removal of the 12.36% service tax levied on commercial rentals in the last year’s budget.

Agrochemicals

- Tax sops (up to 1.5 times cost of research) for companies involved in research of agrochemicals
- Export rebates of 5-10%
- Excise duty cut from 16% to 8%

Fertilizers

- Lower import duty on equipment and some of the key inputs
- Tax incentives for players setting up Greenfield units
- Tax benefits in the form of reduction in custom duty & excise duty
- Income tax holiday for five years for the existing urea units

Cement

- Rationalization of excise duty by way of abatement of ~30-35% on MRP so as to avoid tax on trade margins and tax on tax.
- Reduction in customs duty on imported coal and pet coke (5%)

Hotels

- Extension of tax sops to 5-star hotels in NCR region for Commonwealth Games.
- Rollback of the depreciation rate for hotel buildings to 20%, reduced to 10% in 2003
- Increase in expenditure on tourist infrastructure.
- Hotel industry to be treated at par with other infrastructure sectors and granted full tax benefits under Section 80-IA of the Income Tax Act

Media & Entertainment

- Rationalization of levies for Cable and DTH business
- Reduction and removal of levies for set-top boxes and components
- Removal of Customs duty for digital head end

Paper

- Uniform excise duty of 8 per cent on all varities of paper and paperboard.
- Zero per cent customs duty on import of capital goods required for environmental upgradation
- Retention of customs duty at 10 per cent along with re-introduction of special additional duty

Pharma

- Extend benefits of tax deduction for R&D activities to independent R&D divisions and raise the benefit to 200% (150%)
- Excise duty exemption for all the 354 drugs specified in the National List of Essential Medicines and reduction of excise duty to 8%
- Reduction in custom duty charges on life saving drugs
- To exempt clinical research and intellectual property services from service tax.
- Reintroduce tax exemption benefits for R&D companies up to 2012
- Extension of export related benefits, inclusion of services of ancillary units
- Deduction for Profits from 100% EOU
- Transfer Pricing penalty too harsh. Requests to be lowered
- Fringe Benefit Tax: Exemption of physician samples, conference expenses, travelling expenses etc. and ESOPs

Textiles

- The industry expects increase in duty drawback rate by another 3-4% from the earlier 11%.
- Excise duty on furnace oil, used as an alternative to power, likely to be brought down to 8%.
- Reduction of basic excise duty on textile machinery and equipment to 8% from 16%
- The industry expects reduction in import duty on long staple cotton to 5% from 10% and removal of additional customs duty of 4% on cotton.
- The government likely to continue 2% subvention in export credit leading to effective interest rate to 7%, by another year that is FY09.
- The textile ministry to seek Rs 11000 crore for TUFS allocation in 11th Plan period ending 2012 in the forthcoming budget, as against Rs 4000 crore provided earlier.
- The depreciation rate on plant and machinery expected to be raised to 25% from 15%.
- The industry seeks exemption of fringe benefit tax by garment exporters.

Key Gains

- Increased allocation & thrust for infrastructure
- Overall Improved purchasing power.
- Companies scaling up operations to benefit as a whole.

Key beneficiary industries

- Infrastructure
- Power
- Construction
- Retail
- Capital Goods
- FMCG
- Pharma

B&K Economic Research

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