Budget 2008: Neither reformist, nor populist

Fiscal consolidation remained the priority of the finance minister (FM) in the Union Budget 2007-08 with the fiscal deficit brought down to 3.7% in FY2007 and 3.3% for FY2008 which are in line with the Fiscal Responsibility and Budget Management Act targets. The FM had to tackle a host of things ranging from rising inflation to budgetary impact on the ongoing and upcoming elections. The FM has been able to present a budget that is more or less on expected lines except for the hike in the dividend distribution tax (DDT). His key focus areas in this budget have been agriculture, education and irrigation projects. On the taxation front, he has kept things mostly steady and also announced some additional steps to control inflation in the short term.

At a politically challenging time the FM has kept a tight leash on spending (the non-plan revenue spending is budgeted to increase by only 5.8% in FY2008) and desisted from bringing in populist measures. While he deserves credit for that, there is also a sense of disappointment as he has let go what was possibly the last major opportunity for him to undertake reforms prior to the next general elections.

While the FM could hardly have forecast that there would be a global equity market meltdown on the eve of the budget, his timidity on the reforms front has certainly not helped the prevailing weak sentiment.

Having said that, the actual impact of the budgetary measures is quite marginal except for construction companies. Cement companies will in all likelihood pass on the excise duty hike. Information technology (IT) companies, on the other hand, already pay 8-15% local tax and foreign income tax, and the impact on their earnings will therefore not be of more than 3-5%, depending on how much credit they will get for the taxes paid abroad. The Sensex' valuation is currently at 13x FY2008E earnings (excluding the embedded value of non-income generating assets such as the gas finds of Reliance Industries or the insurance business of ICICI/the Bajaj group). Equity markets will continue to respond to global cues and liquidity flows in the immediate run but India's growth and opportunity is too good for investors to ignore for long.

Key themes of the budget

- Controlling inflation in the near term for which the government has announced a number of steps in line with market expectations.
- Inclusive growth with key focus on improving the agricultural contribution to the gross domestic product (GDP); education and health have also received priority.
- Focus on infrastructure and growth continues with plan outlay up 31% year on year.

Tax implications on IT companies

The levy of the minimum alternate tax (MAT) on income in respect of which deductions are claimed under section 10A/10B would have the following implications for the IT companies:

- First, the move clearly indicates that the government doesn't intend to extend the tax sops to the Software Technology Parks of India registered units beyond the expiry date of March 2009. Though it is contrary to expectations, the move eliminates the uncertainty related to the extension of tax sops and the IT companies can firm up their expansion plans accordingly.
- Second, even considering the worst case (no offsetting permitted against the tax paid onsite or no deferred tax asset allowed to be created), the MAT effective tax rate of the IT companies is expected to increase by 150-450 basis points. Thereby, it would shave off the earnings of the IT companies by 150-500 basis points. The share price of the IT companies have already fallen more than the estimated impact on the earnings per share of the IT companies.
- Third, the levy of MAT would marginally affect the valuations based on the discounted free cash flow method as the cash inflows of just two years (FY2008 and FY2009) are dented by MAT. That's because the IT companies are anyway liable to pay tax at the full rate after the expiry of tax sops in March 2009. Thus, the impact on valuations derived by the free cash flow method would be just 0.5-0.6% according to our calculations.

Key budget highlights

Taxation

Indirect taxes

- Peak customs duty has been reduced from 12.5% to 10%, moving ahead towards comparable East Asian rates.
- Reduction in ad valorem component of excise duty on petrol and diesel from 8% to 6% to help margins of retail petroleum companies.
- Excise exemption limit for small scale industry to be raised from Rs1 crore to Rs1.5 crore.
- Service tax rate kept unchanged at 12% against a consensus expectation of a higher rate of 14%, however some changes have been made to the list attracting service tax.
- The central sales tax has been reduced from 4% to 3% with effect from April 1, 2007 in line with the roadmap for introducing a national level goods and services tax in 2010.

Direct taxes

- The rate of DDT has been raised from 12.5% to 15% on dividends distributed by companies. This would raise the current effective DDT to ~17% from 14% currently.
- Additional cess of 1% levied on all taxes to fund secondary and higher secondary education.
- The threshold limit of exemption in the case of all assessees to be increased by Rs10,000, thereby giving every assessee a relief of Rs1,000.
- Deduction in respect of medical insurance premium under section 80D to be increased to a maximum of Rs15,000 and, in case of a senior citizen, a maximum of Rs20,000.
- MAT to be extended to income in respect of which deduction is claimed under sections 10A and 10B; deduction under section 36(1)(viii) to be restricted to 20% of profits each year.
- Concessions under section 80IA for infrastructure facilities to be extended to cross country natural gas distribution network, including gas pipelines and storage facilities integrated to the network, and to navigation channels in the sea.

Infrastructure funding

- The government is mulling financing infrastructure with foreign exchange reserves by setting up separate subsidiaries which will borrow from the Reserve Bank of India and fund companies' capital expenditure projects only outside the country, so that it doesn't affect domestic liquidity. Exchangeable bonds have also been discussed.

Capital market

- Allow short selling settled by delivery, and securities lending and borrowing to facilitate delivery by institutions.
- Capital gains tax and securities transaction tax have remained unchanged.

Fiscal performance

First, let us take a look at the FY2007 numbers of the government. The revised estimate (RE) suggests that the tax revenues are likely to grow at 26.4% for FY2007 compared with 21% as per budget estimate (BE). The direct and indirect tax collections have surpassed the BEs handsomely. Corporate tax collections increased by 41.4% as per RE compared with 28.4% BE. On the indirect taxation front, only excise duties were lower than BE, however the shortfall was more than made up by the increase in customs and service tax revenues.

On the expenditure front, the RE suggests total expenditure would increase by 14.9% compared with BE of 10.9% with increased interest, subsidies and others. The RE for the fiscal deficit (FD) has gone up by 2.5% to Rs152,328 crore from the BE of Rs148,686 crore. However, as a percentage of the GDP for the year, the FD is now estimated at 3.7% as compared with 3.8% envisaged at the time of the budget. The revenue deficit has also shown an improvement and is expected to be 2% of the GDP as compared with 2.1% anticipated at the time of the budget. For FY2008 the FM expects gross tax revenues to grow by 17.2% and improve the FD in absolute and percentage terms to Rs150,948 crore and 3.3% of GDP respectively.

The figures look conservative and could be expected to be surpassed particularly on the income tax and corporation tax fronts. Primary deficit turning into a surplus is a big positive.

Central government finances for FY2008

(Rs '00 crore)	FY04A	FY05A	FY06A	FY07RE	FY08BE
Gross tax revenues	2,544.0	3,060.0	3,701.4	4,678.3	5,481.2
% change yoy		*20.3*	*21.0*	*26.4*	*17.2*
Net tax revenues	1,870.0	2,248.0	2,702.6	3,459.5	4,038.7
% change yoy		*20.2*	*20.2*	*28.0*	*16.7*
Non-tax revenues	769.0	812.0	772.0	773.6	825.5
Total expenditure	4,713.0	4,976.8	5,061.2	5,816.3	6,805.2
% change yoy		*5.6*	*1.7*	*14.9*	*17.0*
Plan expenditure	1,222.0	1,322.8	1,407.0	1,727.3	2,051.0
% change yoy		*8.2*	*6.4*	*22.8*	*18.7*
Non-plan expenditure	3,491.0	3,654.1	3,654.2	4,089.0	4,754.2
% change yoy		*4.7*	*0.0*	*11.9*	*16.3*
Fiscal deficit	1,231.0	1,252.8	1,464.8	1,523.4	1,509.5
As % of GDP	*4.5*	*4.0*	*4.1*	*3.7*	*3.3*
Revenue deficit	982.0	783.5	923.0	834.5	714.8
As % of GDP	*3.6*	*2.5*	*2.6*	*2.0*	*1.5*
Primary deficit	-10.0	-16.5	138.8	61.5	-80.5
As % of GDP	*0.0*	*-0.1*	*0.4*	*0.1*	*-0.2*

Tax revenues for FY2008

(Rs '00 crore)	FY04A	FY05A	FY06RE	FY07RE	FY08BE
Gross tax revenues	2,544.0	3,060.0	3,701.4	4,678.3	5,481.2
% change yoy		*20.3*	*21.0*	*26.4*	*17.2*
Direct tax	1,050.0	1,339.0	1,698.1	2,290.0	2,671.7
% change yoy		*27.5*	*26.8*	*34.9*	*16.7*
- Corporation tax	636.0	830.0	1,035.7	1,464.9	1,684.0
% change yoy		*30.5*	*24.8*	*41.4*	*15.0*
- Income tax	414.0	509.0	662.4	825.1	987.7
% change yoy		*22.9*	*30.1*	*24.6*	*19.7*
Indirect tax	1,494.0	1,721.0	2,003.3	2,388.3	2,809.5
% change yoy		*15.2*	*16.4*	*19.2*	*17.6*
- Excise duty	908.0	1,007.0	1,120.0	1,172.6	1,302.2
% change yoy		*10.9*	*11.2*	*4.7*	*11.1*
- Customs duty	486.0	563.0	642.2	818.0	987.7
% change yoy		*15.8*	*14.1*	*27.4*	*20.7*
- Service tax	79.0	142.0	230.0	381.7	502.0
% change yoy		*79.7*	*62.0*	*66.0*	*31.5*
- Other taxes	21.0	9.0	11.1	16.0	17.6

Inflation management

The average inflation in 2006-07 is estimated to be between 5.2% and 5.4%, which is higher than last year's 4.4%. We had presented in our pre-budget report ("Run-up to Budget 2007-08" dated February 15, 2007) certain possible steps that the FM could adopt to control inflation. Most of the following steps announced in the budget are on expected lines.

- Peak customs duty reduced to 10% from 12.5%.
- Duty on most chemicals and plastics brought down from 12.5% to 7.5%.
- To check escalating cement prices the excise duty has been raised on cement available above Rs190/bag whereas reduced on cement sold below Rs190/bag.
- New forward contracts in rice and wheat restricted to control speculation on prices of essential commodities.

However, to find a more durable solution to the inflation problem the government has directed its focus on increasing the yield and domestic output of products such as pulses, edible oils, rice and wheat. Unavailability of quality certified seeds have been a key factor for the stagnation in the production and productivity of pulses. For this purpose the government has decided to expand the Integrated Oilseeds, Oil palm, Pulses and Maize Development Programme which should help to increase the yields in the long run.

Fallen angels

In response to the negative announcements in the budget for some of the sectors like cement, IT service and construction sectors, the benchmark indices plunged by about 4% each during the day. As part of the collateral damage, the weak sentiments also dragged down some of the quality stocks where the developments were either positive or neutral. We have listed some of the stocks that offer a good buying opportunity for investors.

Company name	Price on Feb 27 2007	Price on Feb 28 2007	Absolute Change (Rs)	Change (%)
Orchid Chemicals	252.45	227.35	-25.10	-9.94
Ashok Leyland	42.25	39.80	-2.45	-5.80
Aurobindo Pharma	666.15	629.45	-36.70	-5.51
Nicholas Piramal India	237.75	225.00	-12.75	-5.36
Mahindra & Mahindra	849.7	806.05	-43.65	-5.14
Bharat Electronics	1606.95	1,524.50	-82.45	-5.13
Larsen & Toubro	1565.6	1,487.50	-78.10	-4.99
Tata Motors	821.65	783.95	-37.70	-4.59
Ranbaxy Laboratories	352.05	337.60	-14.45	-4.10
Aditya Birla Nuvo	1251.35	1,200.00	-51.35	-4.10
Aban Offshore	1854.00	1,778.00	-76.00	-4.10
Bajaj Auto	2724.25	2,616.95	-107.30	-3.94

Gainers of budget 2007-08

Sector	Companies
Auto	Maruti Udyog, Mahindra & Mahindra
Defence equipment	Bharat Electronics, Astra Micro
FMCG	Britania, ITC, HLL, Nestle, Kohinoor Foods, ICI India
Gems & Jewelry	Vaibhav Gems, Gitanjali Gems, Suashish
IT education	Educomp, NIIT, Aptech
Media	Pyramid Saimira
Oil	HPCL, BPCL, IOC
Pharma	Nicholas Piramal, Ranbaxy, Cipla, Panacea
Textiles	Alok Indusries, Welspun India

Losers of budget 2007-08

Sector	Companies
Cement	Negative for entire sector
Construction	Gammon, HCC, Nagarjuna Construction
Banks & Financial services	HDFC, IDFC and private banks
IT services	Entire sector, most affected HCL Tech and Satyam
Metals	Sesa Goa, NMDC
Real estate	Unitech, Parsvnath, Sobha Developers

Sectoral analysis

Automobiles

Issue	Current Status	Expectation	Announcement	Impact
R&D expenditure	150% weighted deduction (up to Mar 31, 2007).	To be extended for another 10 years.	Extended till 2012.	**Positive** for the sector.
Peak customs duty	12.50%	Reduced to 10%.	Reduced to 10%.	**Positive** for manufacturers having high import content like Maruti Udyog, Sona Koyo Steering Systems and Asahi India Glass.
Thrust on agriculture	Support to irrigation management; farm credit targeted at Rs1.75 lakh crore.	Maintain these measures.	Irrigation measures assured; farm credit target increased to Rs2.25 lakh crore.	**Positive** for M&M, Punjab Tractors and Escorts.

Banking & Financial services

Issue	Current Status	Expectation	Announcement	Impact
Reduce lock-in period for bank deposits U/s 80C, reinstate benefit U/s 80L, increase the TDS ceiling, exempt savings bank interest	Five-year lock-in benefit that allowed tax deduction of Rs12,000 under section 80L withdrawn, interest income on saving deposits taxed and current TDS ceiling at Rs5,000.	Lock-in period reduced to 3 years from 5 years, benefits U/s 80L to be reinstated, savings interest made tax exempt and TDS ceiling to be raised to Rs10,000.	No change.	**Neutral to marginally negative** for the banking sector as nothing was done to make the bank deposits attractive.
Permission to issue tax saving long-term bonds	Many banks are eligible to issue bonds, but unable to price it attractively.	If tax exemptions are given to these bonds, banks will be in a position to attract investor interest.	No change.	**Neutral**.
FBT on ESOP	Not applicable.	No change.	Companies to pay FBT on ESOP from FY2008.	To be **marginally negative** (to affect PAT by 1-2%) for private banks only, like HDFC Bank, ICICI Bank and UTI Bank, since public sector banks don't grant ESOPs.
Modification in Sec 36 1 viii	Banks and certain financial institutions didn't have to pay tax on 40% of the pre-tax profits if the same was retained in a special reserve account.	No change.	The current budget has modified a part of this deduction by reducing the exempt profit from 40% to 20%.	**Negative** for HDFC and IDFC with PAT expected to decline by 4-5%.
Transfer of RBI stake in SBI to the government	RBI holds 55% in SBI unlike other state owned banks' where Government of India is the promoter.	No change.	Although the announcement was not expected in the budget, yet the same was already known to the market.	**Neutral** for SBI.
Dividend distribution tax on dividend declared by mutual fund schemes	Dividend distribution tax on dividends declared by mutual funds scheme stands at 13.07% for individual schemes and 20.71% for corporate schemes.	No change.	Dividend distribution tax on dividends declared by money market and liquid schemes has been increased to 25% for all classes of investors.	Major impact on fund houses with large exposure to liquid schemes like Lotus India AMC, ING Vysya AMC. This would reduce arbitrage opportunities in the money markets and be positive for banking system's liquidity.

Capital Goods & Construction

Issue	Current Status	Expectation	Announcement	Impact
Infrastructure spending		Continue to increase infrastructure spending.	31% increase in Bharat Nirman Programme. Spend of Rs11,000 crore on irrigation in FY2008. Rural water and sanitation supply to receive Rs5,850 crore in FY2008. NHDP to receive Rs10,667 crore in FY2008.Increased budgetary support for APDRP from Rs650 crore to Rs800 crore for FY2008. Increased budgetary support for Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) from Rs3,000 crore to Rs3,983 crore for FY2008.	**Positive:** The existing order backlog and the potential backlog with increased infrastructure spending will ensure greater visibility. This will have positive impact on power ancillary and construction companies, the key beneficiaries for increased budgetary support would be BHEL, L&T, Siemens, Crompton Greaves, KEI Industries, Genus Overseas, Bharat Bijlee and Indo Tech Transformers.
Section 80-IA	The existing provisions of section 80-IA provide for 100% deduction for ten years in respect of profits arising from infrastructure related projects.		Construction companies availing of section 80-IA benefits for contracting revenues in infrastructure segment projects (not classified as "infrastructure" pojects) will have to provide for full tax on contracting profits with retrospective effect from 2000.	The key withdrawal of benefits will be from road projects of NHAI (not classified as "infrastructure" projects), power projects (not classified as "infrastructure" projects), water and irrigation projects and real estate contracting projects. It will have **negative** impact on the construction companies. However the retrospective impact would not be highly significant, as it would vary from company to company, depending on their quantum of profits made during this period. As for the prospective impact, this will increase the effective tax rate of the construction companies to normal 33%+ corporate income tax rate. The impact would be **negative** mainly for IVRCL, Nagarjuna Construction Company, Patel Engineering, HCC, Gammon India and Madhucon Projects. The companies that will not be affected by this would be L&T and Jaiprakash Associates (its construction business) as these have been paying taxes without considering any benefit from Section 80-IA.

Cement

Issue	Current Status	Expectation	Announcement	Impact
Excise duty	Excise duty on cement currently stands at Rs408 per tonne.	Reduced to Rs250 per tonne.	The excise duty on cement will be reduced from Rs400 per tonne to Rs350 per tonne for companies selling at lower than Rs190 per bag whereas the duty on companies selling above Rs190 per bag will be increased to Rs600 per tonne.	This will have a **negative** impact on the companies selling cement above Rs190 per bag, such as ACC, UltraTech et al. But we feel the impact will be neutralised as the companies will be able to pass on the hike to the consumers.
Customs duty on coal/petcoke	Customs duty on coal/petcoke currently stands at 5%.	Reduced to nil.	Status quo.	No impact.

FMCG

Issue	Current Status	Expectation	Announcement	Impact
Alcoholic beverages				
Customs duty	150-312% (including CVD).	No change sought.	No change.	**Neutral** for the sector.
Beverages				
Coffee	Concessional customs duty of 5% on specified plantation machinery valid up to April 30, 2007.	-	Two-year extension up to April 30, 2009. Special funds for replantation and rejuvenation of coffee, rubber and spices.	**Positive** for Tata Coffee and Harrison Malayalam.
Ceramics				
Import duty on raw material	Currently 12.5%.	To be reduced by 1-2%.	Import duty on titanium dioxide reduced to 10% and duty on ceramic colours reduced from 10% to 5%.	**Positive** for Kajaria Ceramics, Nitco Tiles and Murudeshwar Ceramics.
Cigarettes				
Excise/VAT	Tobacco products exempt from VAT. 10% AED on tobacco products.	VAT to be introduced. 10% AED to be scrapped.	VAT not introduced, excise duty increased by 5%, strict regulations on *bidi* manufacturers.	**Positive** for ITC with no VAT and higher rural focus.
CST	4% currently.	To be reduced.	Reduced to 3%.	**Positive** for ITC.
Footwear				
Excise duty on footwear parts	16% currently.	-	Reduced to 8%.	**Positive** for Liberty Shoes, Bata and Mirza International.
Gems & jewellery				
Customs duty	Cut & polished diamonds—5%, rough synthetic gemstones—12.5%.	-	Cut & polished diamonds—3%, rough synthetic gemstones—5%.	**Positive** for Vaibhav Gems, Suashish Diamond and Gitanjali Gems.
Laminates				
Excise duty	Plywood, veneered panels & laminated wood—16%.	-	Reduced to 8%.	**Positive** for Greenply Inds.
Paints				
Import duty on raw material	12.5% currently.	To be reduced to 10%.	Import duty on titanium dioxide reduced to 10%.	**Positive** for ICI and Asian Paints.

FMCG (contd...)

Issue	Current Status	Expectation	Announcement	Impact
Personal & home care products				
Customs duty on soda ash and caustic soda	10% currently.	Likely to be reduced.	No change.	**Neutral**.
Customs duty on dextrose monohydrate	30% currently.	-	Reduced to 20%.	**Slightly negative** for Riddhi Siddhi Gluco Biols.
Excise duty on water purifiers	16% currently.	-	Reduced to Nil.	**Positive** for HLL.
Excise duty on biscuits	8% currently.	-	Fully exempted on biscuits on retail sale price equivalent to Rs50 per kg or less.	**Positive** for Britannia and ITC.
Excise duty on ready-to-eat foods	Duty on some of the processed food products reduced to either 8% or nil.	Excise duty of 16% on a number of processed food products expected to be reduced to 8% or nil.	Excise duty on food mixes reduced from 16% or 8% to nil. Moreover, customs duty on food processing machinery and their parts reduced from 7.5% to 5%.	**Positive** for ITC Foods, Nestle and Kohinoor Foods.
Customs duty on palm oil and other edible oils	Refined bleached and deoderised palm oil, palmolein and other refined palm oils—67.5%.	Headroom left for further reduction.	4% SAD scrapped on edible grade vegetable oils.	**Positive** for Agro Tech Foods and Ruchi Soya.
	Crude palm oil and palmolein—60%.	4% SAD expected to be scrapped.		
	Crude sunflower oil—65%.		Customs duty on crude sunflower oil reduced to 50%.	
	Refined sunflower oil—75%.	Duty on refined sunflower oil expected to get reduced to 65%.	Customs duty on refined sunflower oil reduced to 60%.	

Media and Entertainment

Issue	Current Status	Expectation	Announcement	Impact
CVD on parts of set-top boxes	No CVD.	None.	Exemption from CVD withdrawn on specified parts of STBs.	**Minimal**, as most of the STB demand is met from imports and there is not much import of inputs for STBs.
Reduction of import duty on capital goods	Up to 36%.	Reduced in line with the reduction in peak customs duty.	Peak customs duty reduced from 12.5% to 10%.	**Positive** for the sector as a whole and specifically for broadcasting and radio segments as these are in capex mode.
ESOPs under FBT net	Nil.	None.	ESOPs regarded as fringe benefit.	**Negative** for TV18 (leads to decline in FY08E earnings by ~1.2%) and NDTV (leads to decline in FY08E earnings by ~4.6%).
Service tax on delivery of cinema content in digital form after encryption	Service tax at 12.24%.	None.	Service tax withdrawn.	**Positive** for Pyramid Saimira Theatres and intended users of the technology such as PVR.

Metals

Issue	Current Status	Expectation	Announcement	Impact
Customs duty	Duty on non-ferrous metals, eg copper, aluminum, zinc and tin, cut from 7.5% to 5% in Jan 2007. Duty on ferro-alloy stainless steel and other alloy steel cut from 7.5% to 5% in Jan 2007.	No change.	No change.	No impact.
Customs duty	Duty on calcined alumina cut from 7.5% to 5%.	No change.	No change.	
Customs duty	Duty on copper concentrate currently at 2%.	Likely to be reduced.	No change.	
Customs duty	No export duty.	-	Iron ores and concentrates @Rs300 per tonne. Chrome ores and concentrates @Rs2,000 per tonne.	**Positive** for steel companies like Jindal, Sail. **Negative** for mineral companies like Sesa Goa, NMDC.
Excise duty	16%	May cut to reduce inflation.	No change.	

Oil & Gas/Petrochem

Issue	Current Status	Expectation	Announcement	Impact
Income tax	E&P projects: Seven years of tax holiday.	Extend tax holiday to ten years or make the provision for a block of seven years from the first fifteen years.	No change.	No impact.
Income tax	Cross country natural gas pipelines/storage facility don't have "infrastructure" status.	Infrastructure status sought which would lead to tax exemptions.	"Infrastructure" status granted.	**Positive** for Gail, GSPL.
Customs duty	Different rates for crude oil (5%) and petroleum products (7.5%).	Uniform rate sought.	No change.	
Customs duty	POY, PSF, PTA and MEG rate at 10%.	-	Reduced to 7.5%.	**Marginally negative** for RIL.
CST	4% on oil.	-	Reduced to 3%.	**Positive** for the pure refining companies like CPCL which face under recoveries on CST when selling directly outside their state.
Excise duty	Petrol 8.16% + Rs13.2. Diesel 8.16% + Rs3.32.	Reduce only specific duties or both ad valorem and specific duties.	Petrol 6.18% + Rs13.39. Diesel 6.18% + Rs3.32.	**Positive** for marketing companies like HPCL, BPCL and IOC.

IT services

Issue	Current Status	Expectation	Announcement	Impact
Tax exemptions	Tax exemptions under section 10A for STP registered units to expire by March 2009.	Extension of direct tax exemptions under section 10A on STP registered units for another 10 years beyond 2009, in line with the tax exemption proposed for SEZs.	MAT extended to income in respect of which deduction is claimed under Section 10A/10B of the Income Tax Act. It clearly indicates that the government is not likely to extend the section 10A/10B benefits beyond March 2009.	**Negative** for IT services and BPO companies. Instead of extending the tax benefits under Section 10A/10B beyond 2009, the IT companies have been brought under the MAT regime. Considering the worst case scenario, the development is estimated to increase the effective tax rate of IT companies by 150-450 basis points depending upon the revenue mix (percentage of offshore and domestic revenues), company structure (onsite branches/subsidiaries) and number of offshore units that are already out of tax benefits under section 10A/10B. Consequently, the net profit margins would decline by 40-200 basis points and EPS by 150-500 basis points. This is assuming that the government would not allow any offset against tax paid in other countries. Among the front-line companies we expect a higher impact on Satyam and HCL Tech, as their effective tax rate is relatively lower at below 10%. Least impacted would Tata Elxsi (among the stocks under our coverage) due to reasonably high proportion of domestic revenues.
FBT on employee stock options.	Not under FBT.	No change was expected.	Stock option-based compensation brought under FBT regime with effect from April 2008.	**Negative** as stock options as an instrument to retain talent would turn even more unattractive. Companies most affected would be Satyam Computer and HCL Tech. Least affected would be TCS (as it has not given any stock options).

Pharmaceutical

Issue	Current Status	Expectation	Announcement	Impact
Spending on the healthcare sector	Spending on National Rural Health Mission (NRHM) stands at Rs8,207 crore, and spending on health and family welfare stands at Rs12,546 crore.	Maintain the spending allocation in both the areas.	Spending on NRHM increased by 21.2% (to Rs9,947 crore) and on health and family welfare increased by 21.9% to Rs15,291 crore. Mother and childcare, TB and malaria remain the focus areas.	**Positive** for the entire healthcare sector. But the communicable diseases focus would benefit players like IPCA, Ranbaxy and Lupin.
Research and development (R&D)	Weighted deduction of 150% on R&D expenditure incurred up to March 31, 2007 is available for in-house R&D facility.	Extension of the benefit for a few more years beyond March 31, 2007 and an increase in the weighted deduction from 150% to 200%.	Weighted deduction on R&D expenses remains at 150% and is extended for an additional 5 years up to March 31, 2012.	**Positive** for Ranbaxy, Dr Reddy's and Cadila who will be the major gainers. In the mid-cap space Alembic, Torrent and Dishman will be benefited.
Customs duty	Current peak customs duty 12.5%.	Reduction of peak customs duty from 12.5% to 10% is on the cards.	Peak customs duty has been reduced to 10%.	**Positive** for bulk players like Aurobindo, Orchid, Divi's, Dishman and Neuland. Also **positive** for Cipla, Ranbaxy, Sun Pharma & Nicholas. Among MNCs major gainers would be Aventis, Fulford and GSK Pharma.
	7.5% is levied on certain pharma and biotech machinery.	To be maintained at 7.5%.	Reduced the customs duty on 15 specified machinery from 7.5% to 5%.	**Positive** for the pharma industry.
Service tax	Clinical trials and other scientific services are subject to service tax, even if exported.	Clinical trials and other scientific services for foreign clients may be exempted from service tax.	Clinical trials on new drugs have been exempted from service tax.	**Positive** for Nicholas Piramal, Vimta, Jubilant and Biocon.
Elimination of AIDS	Stable focus on eliminating AIDS under National Aids Control program (NACP) I and II.	Maintain the stable focus on elimination of AIDS.	Enhanced focus on elimination of AIDS under NACP-III and expand access to condoms. Increase in the provision for the AIDS control programme to Rs969 crore.	**Positive** for Cipla, Aurobindo and Polar Pharma.
Eradication of polio	Target to eliminate polio from the country by December 2007.	Maintain efforts and focus to eliminate polio by December 2007.	Allocated Rs1,290 crore towards polio eradication by increased vaccination programmes.	**Positive** for Panacea Biotech.
Excise duty	MRP-based 16% excise structure and 42.5% abatement.	Reduction of excise duty to 8% and/or an increase in the abatement to 52%.	No change.	No impact.

Real Estate

Issue	Current Status	Expectation	Announcement	Impact
Service tax on rent/lease income	No service tax on rent/leases	No change expected.	Service tax levied on commercial leases.	**Negative** for the real estate developers as they might find it difficult to pass on the entire burden to users. In the worst case, the developer might have to bear the entire burden of service tax.
Service tax on works contracts	Not under the service tax net	No change was expected.	Included under the service tax regime.	Real estate developers would have to share the service tax on construction/work contract given to construction companies' contractors (like Gammon, HCC etc).
Tax exemption in specific areas	No tax holiday on hotels	Tax exemption was expected in NCR to boost investment before the Commonwealth Games.	Five-year income tax holiday for new 2,3 and 4 star hotels developed in NCR and some other specified towns close to Delhi over the next three years.	**Positive** for real estate developers like Unitech, Ansal Properties and Parsvnath which have a strong presence in the NCR region.
Excise duty on cement (key raw material)	Excise duty of Rs408/MT paid currently.	Was expected to come down to Rs250/MT.	Increase in excise duty to Rs600/MT for cement sold at above Rs190 per bag.	Cement companies are likely to pass on (at least partially) the increase in excise duty to end users including real estate developers. This would increase the overall construction cost.

Telecom services

Issue	Current Status	Expectation	Announcement	Impact
Licence fee as revenue share	Revenue share is based on category of circle: 10% for metros, 8% for category A circles and 6% for category B circles.	Reduce to a uniform rate of 6% across all circles.	No change.	**No impact** as it was not anticipated.
Corporate tax	Benefits under section 80IA applicable for five years. However, the telecom operators have to pay MAT, which mitigates the impact of the benefits under section 80IA.	Extend the benefits under section 80IA and make an amendment to section 115JB related to MAT.	No amendment to the effect in section 115JB. In fact, the additional cess of 1% would marginally increase the effective tax rate.	**Marginally negative** due to levy of additional 1% cess that would result in a slight increase in the tax outgo.
Service tax	Service tax of 12% applicable.	Increase in service tax rate.	Service tax rate unchanged. However, the additional 1% cess would increase the effective service tax rate marginally.	**Positive** for telecom companies as an increase in the service tax rate would have put additional burden on users.
Customs duty	Additional duty of 4% levied on mobile handsets.	Removal of additional duty of 4% on handsets.	Additional customs duty of 4% on cell phone components, parts and accessories has been exempt.	**Positive** for telecom companies as it would provide impetus to local manufacturing of cell phones.

Tourism

Issue	Current Status	Expectation	Announcement	Impact
Tax holiday	Nil	Ten-year tax holiday sought for all tourism projects.	Increase the provision for building tourist infrastructure from Rs423 crore to Rs520 crore, 5-year tax holiday for 2, 3 & 4 star hotels as well as convention centres with a seating capacity of not less than 3,000, built and commencing operations in NCR during the April 1, 2007 to March 31, 2010 period.	**Positive** for Indian Hotels, Hotel Leela, Taj GVK and Royal Orchid.

Tyres

Issue	Current Status	Expectation	Announcement	Impact
Peak customs duty	12.50%.	Reduced to 10%.	Reduced to 10%.	**Positive** for the sector as it would reduce the cost of SBR, PBR and NTC.

The author doesn't hold any investment in any of the companies mentioned in the article.

Abbreviations used in the report

AED: additional excise duty
APDRP: Accelerated Power Development and Reforms Programme
BPCL: Bharat Petroleum Corporation Ltd
BPO: business process outsourcing
CAS: conditional access system
CPCL: Chennai Petroleum Corporation Ltd
CST: central sales tax
CVD: countervailing duty
DTH: direct-to-home
E&P: Exploration and production
ESOP: Employee Stock Option Plan
FBT: Fringed benefit tax
HCC: Hindustan Construction Company
HLL: Hindustan Lever Ltd
HPCL: Hindustan Petroleum Corporation Ltd
IOC: Indian Oil Corporation
IT: information technology
IVRCL: IVRCL Infrastructure and Projects
L&T: Larsen and Toubro
MAT: minimum alternate tax
MEG: Monoethylene glycol
MNC: Multinational
MRP: maximum retail price
MRP: Maximum retail price
MSO: multi-system operator
NCR: National Capital Region
NHAI: National Highways Authority of India
NTC: nylon tyre cord
OEM: original equipment manufacturer
ONGC: Oil and Natural Gas Corporation
PAT: Profit after tax
PBR: poly butadiene rubber
POY: partially oriented yarn
PSF: polyester staple fibre
PTA: pure terephthalic acid
R&D: research and development
RIL: Reliance Industries Ltd
SAD: special additional duty
SBR: Styrene butadiene rubber
SEZ: special economic zone
STB: set-top box
STP: software technology park
TCS: Tata Consultancy Services
TDS: tax deduction at source
VAT: value-added tax