

# Pre-Budget Memorandum 2019-20

# **MVIRDC World Trade Center Mumbai**

India's Finance Minister will present the full year Union Budget for 2019-20 on July 5, 2019 in the Parliament. The Budget will be presented at a time when the economy is showing visible signs of slowdown from multiple dimensions. Therefore, this Budget must clearly lay down the action plan of the government to achieve efficient utilization of fiscal resources, build physical and social infrastructure and promote a conducive economic environment for agriculture and industry to flourish.

With the objective of setting the economy on a high-growth trajectory, MVIRDC World Trade Center Mumbai suggests the following development priorities to the government. This Memorandum also contains views from experts to meet the specified objective.

India's consumption demand, which is the major engine of economic growth, is losing momentum as is evident from decline in sales of passenger vehicles, two wheelers, fast moving consumer goods etc. Private consumption contributes around 59 per cent to the overall GDP of the country.

Therefore, the first policy priority of the Union Budget will be to drive private consumption, especially rural consumption in the economy in ways that do not compromise the fiscal prudence of the government. It may be difficult for the government to provide income tax exemptions to spur consumption at a time when its tax collection is falling considerably and it cannot breach the fiscal deficit target of 3.4 per cent. In the last fiscal year (2018-19), Government of India's direct tax revenue stood at Rs. 11.4 lakh crore, which is less than its revised estimate of Rs. 12 lakh crore. Hence, the only sustainable way to boost consumption is by creating livelihood opportunities for rural people, ensuring farmers get remunerative price for their produce (through effective procurement mechanism), expediting planned investment in rural infrastructure etc.

The Union Budget must also feature announcements on rationalizing direct and indirect tax systems to increase tax base and disincentivise tax evasion. The Finance Minister must assure a progressive tax regime devoid of any draconian rules or actions that harass the honest tax payers. This move will not only increase government's tax revenue but also enable the government spend more on infrastructure and welfare programmes.

From the expenditure side, the Finance Minister must use this opportunity to announce roadmap for rationalizing various subsidies by removing subsidies which are misused or which do not reach the intended beneficiaries. Government of India spends 8.5 per cent of its total expenditure on food, fuel and fertilizer subsidies. Besides this, there are several minor subsidies such as interest subsidy for farmers, export subsidies, credit-linked subsidies for weaker sections etc. The government must conduct an impact evaluation study to assess the effectiveness of these subsidies.

Another key focus area for this budget should be strengthening the financial sector. When credit growth in the banking sector decelerated in the last few years because of the bad loan problem, Non Banking Finance Companies (NBFCs) and Housing Finance Companies (HFCs) supported the industry. Today, NBFCs account for 20 per cent of the total credit to the industry. Also, these NBFCs were the key drivers of consumer loans and auto loans in the economy. Today, some of these NBFCs and HFCs are facing



financial stress because of the asset-liability mismatch. Under this condition, the Union Budget must allocate sufficient funds to recapitalize the banking sector so that strong banks can acquire some of the assets of NBFCs.

This Union Budget must also lay down clear plans for addressing agrarian distress, supporting MSMEs and building infrastructure. The government must partner with industry to create a sustainable farm value chain in the country and increase India's capacity to export value added agro-commodities. India does not have a robust food processing infrastructure, despite it being a major producer of foodgrains and horticulture. Also, India's agriculture exports as a share of GDP stands low at 2 per cent, compared to 9 per cent in Thailand, 7 per cent in Argentina and 4 per cent in Brazil.

On the infrastructure sector, the Union Budget must reaffirm the administration's commitment to complete dedicated rail freight corridor project by 2022, expedite Sagarmala and Bharatmala projects, increase the number of functional airports to 202 in five years, as outlined in the government's election manifesto.

With this broad theme in mind, the Union Government may consider the following specific actions to support growth and socio-economic development in the economy:

<u>Funding for Infrastructure Sector:</u> The share of bank credit to the infrastructure sector has declined from 15 per cent in 2015 to 12.2 per cent in 2019, although it is slightly higher than 11.5 per cent in the previous year. In order to address the funding gap in this crucial sector, the government must take the following steps:

- 1. Set up credit enhancement fund: Infrastructure projects are generally considered risky because of their long gestation period. In order to enhance credit rating for infrastructure projects, the government may set up a bond guarantee or credit enhancement fund. Under this fund, the government may guarantee the bond issuance of infrastructure companies who have at least BBB (investment grade ratings). Such a move will encourage pension funds and insurance companies to invest in these infrastructure bonds.
- 2. Promote use of Expected Loss rating scale: Traditionally, rating agencies use probability of default (PD) method for rating infrastructure projects. However, government must promote the use of expected loss rating scale, which will attract long term investors such as pension and insurance funds to invest in infrastructure projects.
- 3. Miscellaneous steps: The government must make public private partnership model attractive for private sector by designing optimal risk sharing mechanism and honouring its contractual obligations. Also, government must relax some of the guidelines that restrict the investment of pension and insurance funds in infrastructure projects. Further, wherever possible, the government must monetize non-core assets of Railways, BSNL, NHAI and other agencies and use the proceeds for building infrastructure.

<u>Set up MSME Clinic</u>: Micro, small and medium enterprises (MSMEs) are the backbone of the country as they account for 45 per cent of exports, 40 per cent of manufacturing and contribute 37 per cent to GDP of the country. Over the course of time, lakhs of MSMEs across the country has become sick because of adverse market condition, delayed payment by customers, excessive competition and other factors.



Government of India must encourage state governments to set up MSME Clinic on the lines of Government of Telangana. The Telangana government set up an Industrial Clinic to rehabilitate sick MSMEs by offering them financial and consultancy support. The Telangana Industrial Health Clinic Ltd (TIHCL) was set up as fintech driven Non-Banking Finance Company (NBFC) with equity participation from Government of Telangana, Government of India, financial institutions, MSMEs and investors in 2017. The Clinic offers managerial, technological and marketing support to revive, rehabilitate and restructure sick, but viable MSMEs. TIHCL has successfully revived more than 33 MSMEs in the first year of its operation.

Address stress in NBFC and HFC sector: Non Banking Finance Companies (NBFCs) and Housing Finance Companies (HFCs) were the major drivers of consumer lending and real estate funding in India. Today, some of these companies are facing financial stress as they depended on short-term bond market to finance long term assets. As a result of the heightened risk perception, mutual funds and banks are unwilling to finance this sector. Reserve Bank of India must conduct an asset quality review of all the NBFCs and HFCs in order to assess their financial condition. Such an exercise will help mutual funds and other investors to identify financially strong players and financially weak or insolvent players. This will help financially strong NBFCs to raise funds from the market.

<u>Bank Recapitalisation:</u> In the short-to-medium run, the government must allocate sufficient funds for recapitalizing weak banks in order to expedite their exit from the Prompt Corrective Action (PCA) framework of the RBI. Further, the government must fast-track reforms in the banking sector, which includes merging of weak banks with strong ones, improving their governance standards, enhance their credit appraisal capability etc.

<u>Introduce norms for cross-border insolvency</u>: The current form of the Insolvency and Bankruptcy Code (IBC) does not allow foreign lenders to initiate bankruptcy resolution against Indian borrowers. Although the Code has cross-border insolvency provisions in sections 234 and 235, they cannot be enforced as they are not notified. Therefore, the government must suitably amend the existing IBC to make way for foreign lenders to initiate bankruptcy resolution against Indian borrowers. Such a move will strengthen the confidence of foreign investors in India's legal system.

<u>Ease of Doing Business</u>: India's ease of doing business (EoDB) ranking has improved from 130 to 77 in the last two years. However, the country still holds poor ranking in certain indicators such as registering property (166<sup>th</sup> rank), enforcing contracts (163<sup>th</sup> rank), resolving insolvency (108<sup>th</sup> rank), starting a business (137<sup>th</sup> rank). Therefore, Union Budget must contain key announcements on proposed policy measures to improve ease of doing business on these areas.

Abolish dual Licensing: Government must remove dual control of food business operators by the central and state governments. At present, food business operators with size of operations beyond a specified limit will have to obtain license from both the central government and the respective state government, where it has operation. Such a dual control adds to the compliance burden of the food business operator. The Food Safety and Standards Authority of India (FSSAI) has suggested the elimination of this dual control. According to the authority, food business operators whose presence is limited to a single state can be allowed to obtain license from that state government, irrespective of its size. On the other hand, those food business operators who operate across more than one state can be brought under the regulation of the central government.



Tax incentives to promote digital transactions: Government of India must abolish the 18 per cent import duty on point-of-sale devices, which are used by merchants to promote cash-less transactions. At a time Government of India is aiming for a digital society and less-cash economy, there is a need to encourage merchants and consumers to adopt digital transactions. Recently, the Nandan Nilekani-led committee on Deepening of Digital Payments also recommended the removal of import duty on PoS devices. In fact, the committee has also suggested the reduction of Goods and Services Tax (GST) on digital transactions to encourage digital payments. Citing the successful example of South Korea, the committee suggested providing tax incentives to businesses that are adopting digital transactions with its customers, suppliers, government agencies and others. The government must accept the suggestions of the committee to promote digital transactions in the economy.

Abolish Cess and Surcharge: The central government has been increasing cess and surcharge to tide over shortfall in its revenue collections. While the government has removed most of the cess and surcharge from indirect taxes, the same continues to remain in direct taxes. The government imposes 4 per cent education and health cess on individuals and companies. Further, individuals, companies and association of individuals pay 15 per cent surcharge if their taxable income exceeds Rs. 1 crore. The comparable surcharge for tax payers with income less than Rs. 1 crore and more than Rs. 50 lakh is 10 per cent. Since 2012-13, the surcharge and cess imposed on companies have risen from 5 per cent to 15 per cent (of their basic income tax), while for individuals, the corresponding figure has risen from 3 per cent to 5 per cent. While cess and surcharge were introduced as temporary measures to tide over shortfall in revenues, they have become a permanent feature in our tax system. Cess and surcharge imposes additional burden on genuine tax payers. Also, it does not benefit the state governments as revenue collected from cess and surcharge is not shared with state governments. Instead of imposing surcharge, the government must enhance its tax collection by bringing evaders under the tax net. In a country of more than 1.2 billion people, hardly 81,300 individuals declared gross income of more than Rs.1 crore for assessment year 2017-18 (or financial year 2016-17). The Union Budget 2019-20 must make a beginning by reducing surcharge and cess and provide a roadmap for completely eliminating the same in the coming years.

Adoption of XBRL: At a time when Government of India is fast adopting the concept of e-Governance, XBRL can be a promising tool for reporting data on public expenditure, revenue and other fiscal numbers. XBRL is a world-wide financial data reporting software developed by global non-profit organisation XBRL International Inc. XBRL provides a common, electronic format for reporting data by replacing the old, paper-based reporting, which is time consuming and inefficient. World-over this data reporting standard is adopted by tax authorities, financial sector regulators for monitoring and supervising companies. In India, the Ministry of Corporate Affairs and Reserve Bank of India have adopted this software for reporting of financial data by companies. Other departments of the government must also consider adopting this standard for efficient delivery of their welfare programmes, to avoid leakage of allocated funds and monitoring the implementation of programmes at the grassroot levels. For instance, the Ministry of Rural Development, Government of India can better track the implementation of its programmes through its registered non government organizations (NGOs) under XBRL standard. XBRL report standard can also be adopted by municipal corporations across the country so that their financial data can be efficiently reported and tracked by the respective state government and also the central government. Government of India must set up a working group to study the application of XBRL in various ministries and at different levels of administration. For instance,



the Ministry of Housing and Urban Development can track the progress of its policy programmes across various local bodies by encouraging municipal authorities to report data under XBRL format.

Increase duty on Palm Oil Imports: Recent months have witnessed surge in import of palm oil from Malaysia as the country enjoys concessional access to our market under the Comprehensive Economic Cooperation Agreement (CECA). India's import of RBD palmolein has risen 140 per cent to 312,000 tonne as of March 2019 from 130,000 tonne in December 2018. The sharp rise in the import of palm oil has hurt the domestic oil palm plantation and palm oil refinery, besides hurting the price realization of mustard farmers. With the surge in palm oil import, the market price of mustard has declined to Rs. 3500 per quintal as against the minimum support price (MSP) of Rs 4200 per quintal.

Therefore, in order to protect the interest of domestic mustard farmers and palm oil industry, the government must invoke the 'Bilateral Safeguards' as referred in Article 5 of Chapter 5 of 'Trade Remedy' of the CECA.

#### Start-up Enterprises

Government of India introduced more than 150 schemes and policies for startup enterprises in the last five years. However, still the startup community faces several challenges in ease of doing business, in terms of complex procedures for filing patents, tax litigations, export-import documentations, access to risk capital etc.

Particularly, start-up enterprises need a simplified GST compliance procedure and clarity on rules governing inward and outward remittances. Considering that startup enterprises have a high mortality rate, the government must ease the procedure for entry and exit of such enterprises.

Among other demands, startup companies want the government to ease norms for raising funds through initial public offering (IPO) and allow differential voting rights. Differential voting rights enable founders of startup enterprises to raise equity capital from investors without losing their voting rights.

# **Agriculture and Food Processing**

<u>Enhance Investment in Agriculture</u>: India must increase its investment in the agriculture and allied sectors for research on better seed varieties, improving irrigation and water management facilities, skill development for farmers, enhancing soil health and developing post-harvest facilities. Data from FAO shows, India's gross fixed capital formation in the agriculture and allied sector stands at 13 per cent of its total value added in this sector, compared to 21 per cent in South Africa, 20 per cent in Indonesia and 17 per cent in Sri Lanka. In order to increase private investment in the agriculture sector, government must promote contract farming and support start-up enterprises that offer innovative farm solutions.

Besides promoting private investment, government must also allocate more funds for agriculture investment. Today, government spending on agriculture sector is largely in the form of input subsidies (fertilizer subsidies, subsidized credit, power and irrigation subsidy, insurance subsidy), which together accounts for 8 per cent of agriculture GDP (as of 2015). On the other hand, government investment in agriculture sector stands at a paltry 2.2 per cent of GDP in 2014-15, which has declined from 3.9 per cent in 1980-81. According to research scholars, public expenditure on agriculture research and development yields better outcome in terms of agriculture productivity and poverty alleviation



compared to expenditure on input subsidies. Therefore, it is time that the Union Budget reconsider its allocation for various farm input subsidies and spend more on agriculture investment.

Agriculture should be shifted from State List to Concurrent List: The Central Government must introduce a Constitutional Amendment Bill to move agriculture from the State List to the Concurrent List. By classifying agriculture under the Concurrent List, Government of India can take politically bold decisions on land leasing, contract farming, removing the restrictive mandi system and other areas where state governments could not make noticeable progress.

Even though agriculture is classified under State List, it is the central government that takes strategic policy measures for this sector. For example, the central government announces minimum support price for farmers, procures foodgrains at this price, decides on foreign trade policy for farm commodities, decides on agriculture trading in futures market, announces annual target for farm credit, announces policy for integration of all agricultural mandis across states and so on. The central government has also introduced several laws that have bearing on the agriculture sector. These laws include National Food Security Law, The Biological Diversity Act, Protection of Plant Varieties and Farmers' Rights Act etc. therefore, agriculture must be rightfully classified under Concurrent List.

<u>Set up village level procurement centres</u>: According to a UN estimate, 40 per cent of India's farm production is wasted because of poor post-harvest infrastructure. A study by NITI Aayog found that India's agriculture sector suffers from Rs. 90,000 crore worth of post-harvest losses annually. The government must collaborate with the private sector to set up post-harvest infrastructure such as storage facilities and pack-house near the farm gate. As a first step, the government may set up procurement centres for perishable goods such as fruits, vegetables and dairy near farm gate. These procurement centres can be linked to rural haats, which are informal markets mostly owned by local bodies and gram panchayats. The Union Budget 2018-19 announced the upgradation of 22,000 rural haats into Gramin Agriculture Markets (GrAMS). The government must partner with private companies to upgrade these rural haats with all modern facilities for post-harvest processing and storage.

<u>Incentivise crop diversification</u>: For several decades, Indian farmers have been incentivized to grow water-intensive crops such as rice, wheat and sugarcane because of the existing procurement and state-assured pricing policy. Growing such water intensive crops in chronically drought prone areas will result in early depletion of ground water. Although sugarcane is grown on just 4 per cent of the cultivated area in Maharashtra, the crop consumes 65 per cent of irrigation water. Similarly, rice and sugarcane together consume 70 per cent of irrigation water in Karnataka even as they are grown in only 20 per cent of the cultivated farmland.

<u>Increase allocation to FSSAI</u>: The Food Safety and Standards Authority of India (FSSAI) is suffering from lack of sufficient funds and manpower to regulate the huge formal and informal food business operators in the country. According to a Parliamentary Committee report in 2018, FSSAI is severely understaffed and it is relying on state food regulators to carry out its operations. The report calls for recruiting permanent technical staffs for conducting its regular food safety audit and inspections. There are almost 25 lakh eating outlets in India, including restaurants, dhabas, kiosks etc. Of these outlets, only 4.67 lakhs are licensed outlets. It is necessary to expand the manpower of FSSAI to bring all these outlets under licensing and regulation. Bringing all the unlicensed entities under regulation can potentially reduce the incidence of food-borne diseases in India, which imposes a cost of USD 15 million annually. This calls for



increasing the budgetary allocation for FSSAI. In the year 2018-19, FSSAI received just USD 20 million against a budgeted outlay of USD 49 million. This outlay pales in comparison to the corresponding figure in other countries, Canada (USD 650 million), UK (106 million) and USA (USD 1.5 billion) — countries which do not have such a huge consumer market and food business operators as ours.

#### Water Conservation

Set up water regulatory authority: Many parts of India are suffering from falling ground water table because of indiscriminate use of water in agriculture and industry. Around 90 per cent of groundwater is used for irrigating farm land. According to one estimate, out of the 6584 groundwater assessment units in the country, 1034 units have been over-exploited, 253 units are categorized as critical, while another 681 units are semi-critical. In order to discourage indiscriminate use of ground water and ensure equitable distribution of groundwater among household, agriculture and industry, there is a need for setting up an independent and statutory water regulatory authority in all states. Water is a state subject in India. Maharashtra is the first state in India to set up an independent water regulatory authority. Although 14 states have decided to set up water regulatory authority, many of them are yet to be functional. Reports suggest that even though the Thirteenth Finance Commission suggested a grant of Rs. 5,000 crore to state governments for setting up such an authority, only 28 per cent was released so far.

Such an authority can fix charges for using groundwater for different purposes such as drinking, farming, industrial application etc. The authority will ensure that water charges are determined for various uses through a consultative and transparent manner. The pricing mechanism for water must encourage efficiency of use, water conservation and equitable distribution among rich and poor.

<u>Enactment of National Water Framework Bill</u>: Government of India introduced the Draft National Water Framework Bill in 2016 to outline the principle of pricing water. Water being a vital and stressed natural resource, the Bill envisages a national legal framework for protecting, conserving, regulating and managing this resource. Since then, nine state governments have offered their comments on the Bill. The central government must work with all the state governments to create consensus for this Bill and enact it in Parliament at the earliest.

#### Goods and Services Tax

<u>Structural Change in GST</u>: It has been almost two years since the biggest indirect tax reform, Goods and Services Tax (GST) was introduced in India. Indian tax payers have gradually adapted to this new tax system and government's monthly revenue collection also seems to be improving of late. It is time the government brings the left out items, namely electricity duty, petroleum products and real estate under the GST. This will not only remove the cascading effect of taxes in these sectors, but also bring the entire economy under one uniform tax system.

<u>Move towards a two-rate structure</u>: In order to simplify the GST system, the government may move away from the multiple rate structure to a two-rate structure. The government can consider adopting a two-rate GST structure with 6-8 per cent as the lower rate and 12-16 per cent as higher rate for luxury goods. The government may also introduce a third rate for de-merit goods or services to discourage their consumption.



<u>Guidelines for Anti-profiteering norms</u>: Companies from consumer durable and non-durable industry have been seeking clear rules and guidelines on the applicability of anti-profiteering provisions under the GST. Absence of clear guidelines has resulted in imposition of heavy penalty by the National Anti-Profiteering Authority (NAA) on these companies for not passing the reducing in GST to end consumers. For instance, India's leading FMCG companies such as HUL, P&G, Nestle have been fined Rs 462 crore, Rs. 250 crore and Rs 100 crore respectively for not passing on the GST reduction to consumers. However, companies claim that they have passed on the benefit of the reduction in tax rate either by reducing the price of the product or by offering more volume for the same price. Industry players feel there is no clear guideline to determine whether the company has passed on the benefit to the end consumer. Therefore, the GST Council must release a clear guideline in this regard.

# **Views from Experts**

# Priorities for the Budget 2019-20

Mr. Sunil S. Bhandare, Director, The Saraswat Cooperative Bank

### President - All-India Bank Depositors' Association

#### Introduction

Political stability is a *sine qua non* of macro economic stabilization, acceleration of the reforms process and inducing economic resurgence. Fortunately, the post-election scenario has ensured a distinctive political stability, and there is no "crisis" like socio-economic situation in the country, albeit there are several patches of acute pressures and pains. Most of the current tough economic challenges manifest through rapidly decelerating economic growth, severity of rural distress, rising joblessness, stagnating investments, sharply shrinking manufacturing growth, persistent lack-luster export performance, fumbling financial sector, including the current desperate plight of NBFCs, et al. At the same time, fiscal space is severely constrained thanks to inadequate buoyancy of tax and non-tax revenues in the midst of rapidly growing commitments to several new social welfare programs as well as normally rising requirements of a host of existing budgetary allocations.

On the external side, there is virtually nothing to feel sanguine about. Indeed, global economic activity has been loosing pace, especially in the EURO area and many of the emerging market economies. The scenario is no different in most parts of BRICS economies. There is considerable volatility in crude oil prices, which are influenced not only by the OPEC countries production stance, but also by the geopolitical conditions in the Middle-East region and tensions surrounding several major oil producing countries. To make things even more complex and worrisome are the growing specter of trade wars, largely driven by the present US administration, and uncertainties associated with BREXIT.

Keeping such broader perspectives in view, the Finance Minister Nirmala Seetharaman is certainly faced with formidable challenges in formulating and scripting the forthcoming budget. She has to usher long awaited optimistic and powerfully positive impact-making phase of economic resurgence. It is truly the



most opportune time to unfold policies, strategies and programs of the Modi Government 2.0, signaling the shape of things to come both in shorter-term annual budgetary perspective as well as over the next five years of its tenure. Not just the voters, who have elected the government to power, but public at large, would be genuinely eager to see what is going to be in store for them. How the government responds to their expectations and aspirations – and all of that being stimulated by the grand electoral performance of the new government.

#### Steering the Determinants of Budgetary Strategy

Surely, the FM has virtually no luxury of time; she has to combat head-on all the tasks without any distractions and procrastinations, as the budget will be perceived as the most comprehensive and meaningful document, setting out refurbished vision-mission-objectives of the government. Intrinsically, it would be governed by three major considerations, namely, (a) the substantive dimensions of the Interim Budget already presented by the Modi Government 1.0 on February 1, 2019: (b) a host of promises made in the BJP's election manifesto; and (c) various post-election pointers as given out by the spokespersons of the government, and more importantly by the Prime Minister *per se*. Among other things, the PM has covetously spoken about his ambition of making India the US\$5 trillion economy by 2024, and US\$10 trillion economy over the next eight years.

Thus, illustratively, what transpire from the Interim Budget are several new lofty social welfare programs such as Pradhan Mantri Kisan Samman Nidhi (PM-KISAN) to provide an assured income support to the small and marginal farmers. Under this program, vulnerable landholding farmer families, having cultivable land up to 2 hectares, will be provided direct income support at the rate of Rs.6,000 per year. It is projected to benefit around 120 million small and marginal farmer families that would entail an annual spending of as much as Rs.75,000 crore.

Like-wise, it has been proposed to launch a mega pension yojana, namely 'Pradhan Mantri Shram-Yogi Maandhan' for the unorganized sector workers with monthly income up to Rs. 15,000. It will assure monthly pension of Rs.3,000 from the age of 60 years and the concerned worker will have to make a small monthly contribution during their working age with an equal share coming from the government. Over the next five years, it is projected to become one of the largest pension schemes in the world. A token provision of Rs.500 crore has been made with the promise of additional funds that may be required. The Interim Budget also offered some welcome benefits to individual taxpayers at the lower end of the income pyramid.

But far more significant has been the laying out of the Modi government's ambitious ten-point vision 2030, which included every single major aspect of our socio-economic development such as commitment to (a) building up ambitious physical infrastructure (roads, railways, seaports, airports, urban transport, gas and electric transmission and inland waterways) and social infrastructure promising every family to have a roof on its head and to live in a healthy, clean and wholesome environment; (b) creating Digital India, which reaches every sector of the economy and every corner of the country; (c) making India a pollution free nation with green Mother Earth and blue skies; (d) expanding rural industrialization using modern digital technologies; (e) generating massive employment by focusing upon the Make in India approach to develop grass-roots level clusters, structures and mechanisms encompassing the MSMEs, village industries and spread of start-ups and becoming a global manufacturing hub in various sectors like automobiles and electronics, defence and medical devices; (f)



working vigorously towards Clean Rivers and ensuring safe drinking water to all Indians; (g) exploiting full potential of India's long coastline; and so on.

Surely, the forthcoming full-fledged budget has to provide substantive support to what has already been outlined in the Interim Budget. At the same time, the vision of making India a 5-trillion dollar economy by 2024 – that is over a period of next five years – entails annual average growth rate in nominal terms of well over 13% as against 11.1% growth rate achieved in the previous five years. This sounds quite realistic and doable. Assuming an average annual inflation of 4% over the next five years, the real GDP growth has to accelerate to over 8.6% per annum as compared to 7.5% in the previous five-year period (2014-19). This would entail, at the macro level, a progressive increase of at least 5 percentage points in India's investment ratio (or gross fixed capital formation to GDP ratio) from the present 32.3% in 2018-19.

#### **Key Macro Priorities for the Budget**

What will stimulate investments in the economy to trigger the virtuous cycle of economic revival? We have to obviously focus on the following initiatives/ reforms:

- (a) Reduction in corporate taxes;
- (b) Softening of the cost of capital lending rates, corporate bond market rates, etc. all of which are inextricably linked to further reduction in the RBI's repo rate and the pursuit of accommodative credit policies. While this is in the domain of the monetary authorities, there is so much that also needs to be done at the fiscal end by the Central Government;
- (c) Public sector infrastructure investment preferably of the Public Private Partnership variety to "crowd in" private investments;
- (d) Reining in fiscal deficit, and more importantly, the broader annual dimension of public sector borrowings requirement (PSBR);
- (e) Selective incentivizing of corporate investments, preferably in labor-intensive industries; and
- (f) Reviving of private consumption expenditure through both rationalization of GST and other indirect taxes as well as effective channeling of public expenditure programs.

Almost all of these trigger points are inter-related and inter-dependent and can work in a mutually supportive and accelerating mode. Several economists and professionals have been writing extensively on many of the policy areas to revive investment and growth in the economy in recent times. But what is critical now is to look at the issues of slowing down of the economy, sluggish investments and jobless growth in a more holistic manner. There has to be firing of growth engines both at the level of consumption expenditure, especially emanating from rural and semi-urban areas, and investment/capital formation across infrastructure development, manufacturing sector, services and exports sector. Given the current hostile and disruptive global trade scenario restraining export promotion, the budgetary policies have to give extreme focus on stimulating domestic demand aggressively – both consumption and investment.



Effectively, the budget has to unfold more tax-friendly environment through a promise of (a) progressive (if not instantaneous) reduction in the corporate tax rates across-the-board from the present 25% to 20% spread over next 3 to 4 years given the extant budgetary constraints; (b) further rationalization of the GST rates structure along with removal of several glitches in its implementation and administration; (c) initiating a new Direct Tax Code (already a work-in-progress for almost a decade now) that is in conformity with the changing needs of modern corporate businesses; and (d) improving the ease of doing business, and in particular helping out assesses and tax authorities in minimizing resort to newer tax litigation, and facilitating the settlement of existing tax disputes.

What have been mentioned so far are the illustrative – and by no means exhaustive – priorities for the forthcoming budget, keeping in view the urgency of stimulating corporate investment for economic resurgence. Surely, there is neither any point in speculating or adding more to the "traffic congestion" of a host of recommendations already made, and are likely to be made by academicians, experts and professionals in the coming days.

#### Reality Check - the Budgetary Arithmetic

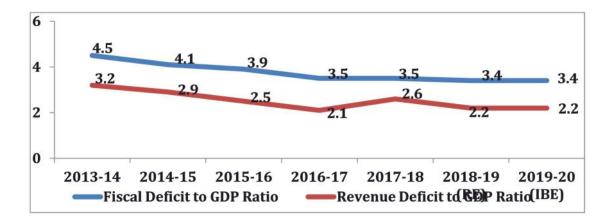
But our reflections on budgetary priorities cannot be oblivious to what is the discernible fiscal space available for the Government of India. That, indeed, is the crux of the matter. All the budgetary expectations, be it in terms of generous allocations for infrastructure and rural development, social welfare schemes or defence expenditure cannot be fulfilled unless there is required buoyancy of tax and non-tax revenues. So also, the demands of the corporates, MSME sector, start-up firms, real estate and construction businesses, exports and many others for radical reduction in corporate tax rates, rationalization of GST into a single rate structure and for sumptuous tax concessions and incentives cannot be met easily and adequately.

	2017-18	2018-19	2019-20	Please Note:
(Rs. Billion)	(Actuals)	(R E)	(IBE)	RE = Revised Estimate
1. Revenue Receipts	14,352	17,297	19,777	IBE = Interim Budget Estimate
2. Capital Receipts	7,068	7,276	8,065	Total Receipts = Total Expend
3. Total Receipts (1+2)	21,420	24,572	27,842	"Expend" = Expenditure
4. Revenue Expend	18,788	21,406	24,479	Billion = Rs.100 crores
5. Capital Expend	2,631	3,166	3,363	
Revenue Deficit (4 – 1)	4,436	4,109	4,702	
Fiscal Deficit	5,911	6,344	7,040	



A quick overview of the Interim Budget data numbers, as shown in the above table, suggests the stringency fiscal constraint or the "narrowness" of the fiscal space of the Central Government's budget. Witness the following facts:

- First, revenue expenditure, which is mostly of a preemptive nature, knocks of over 87% of total receipts, leaving barely 12 to 13% for capital spending. There is virtually no scope to reshuffle revenue expenditure as it consists of committed spending on interest payments, subsidies, administrative expenditure, pensions, social welfare schemes, defence spending, etc.
- Second, the Interim Budget has already anticipated substantial increase in tax revenues, whose
  realization would call for a stronger economic growth, especially of the manufacturing sector. Thus,
  gross tax revenues of the Central Government are projected to expand by 13.5% to Rs.25,521 billion
  in 2019-20 (IBE) on top of 17.2% growth to Rs.22,481 billion in 2018-19 (RE). The scope for
  enhancing this target of gross tax revenues would be marginal.
- Third, other major non-debt avenue for raising the resources is from PSUs' disinvestments. But here too, there a virtual saturation limit seems to have been reached with the target for 2019-20 being placed at Rs.900 billion as compared to Rs.800 billion in the previous year.
- Last, the bottom-line of the fiscal space is governed by the fiscal deficit and revenue deficit ratios, which are depicted in the following chart. What is evident is the fact that for the last three or four years, the efforts to reduce the fiscal deficit to GDP ratio progressively to 3% had to be postponed. There is apparently "stickiness" about this ratio and any effort to dilute the current policy stance on this score would be treated adversely by the international credit rating agencies as well as by domestic financial markets. Higher market borrowings of the government (a reflection of the fiscal slippage) would surely constrain RBI's efforts to cutback the repo rate, keep the cost of capital high for business and industry and effectively "crowd" out the private sector in their investment efforts.



#### Concluding Observations

All in all, the FM Nirmala Seetharaman is faced with the most arduous task – of how to resolve a typical fundamental economic problem of managing rationally the unlimited expectations and demands of the



people at large with limited fiscal resources at her command. The economy is desperately waiting for unleashing of forces of recovery and resurgence. There are all the basic ingredients of resilience at the macro level — moderate inflation, comfortable forex reserves, manageable current account deficit, banking sector gradually regaining from its massive NPA crisis, corporates raring to get started with their programs of expansion and new investment after their long strategic pause of last three or four years, and so on.

In this contextual framework, what is expected is a clear direction from the budgetary strategy even in the midst of limited fiscal space. Equally important are going to be the government's non-budgetary policy initiatives for stimulating the overall investment and growth outlook. These would include reforms of labor and land markets, further improvement in the ease of doing business, making tax administration more proactive and investment-friendly, further liberalization of FDI, strengthening institutional structure of cooperative federalism for ensuring more participative reforms by the Center and States to promote balanced and inclusive economic development. How much of all our expectations and aspirations are going to be fulfilled would be clearly known on the D-day of the budget – July 5, 2019!!!

### **Pre-Budget Expectations - Direct Taxes**

# Mr. Firoze B. Andhyarujina, Senior Counsel, Supreme Court of India

#### **Dividend Distribution Tax**

When a company earns profits, taxes are imposed on these profits. After earning profits, when the company declares, distributes or pays dividend, it has to pay Dividend Distribution Tax. Then, when it is passed on to the shareholder, if the amount of dividend is greater than Rs. 10 lacs, it is again taxed in the hands of the shareholder at the rate of 10 per cent. So, this amounts to triple taxation, first on profits, then on dividend, and finally on the shareholder's income. No other country in the world has this kind of regressive triple taxation system. Therefore, the Budget should ensure that no tax is levied on the shareholder's income.

Secondly, several people have recommended that in case of the above, the tax should be imposed on the shareholder and not the company. In other words, the Dividend Distribution Tax should be replaced by taxing only the recipient. If this is adopted, it will be detrimental to increasing revenues for the government since a lot of bogus or fictitious accounts will be created and after collecting the dividend, these accounts will be closed. Therefore, the government should ensure that the tax is imposed on the companies at the time of declaring dividend rather than taxing the recipient shareholder.

# **Long Term Capital Gains Tax**

The Long Term Capital Gains Tax imposed on shares sold in the stock market should be abolished. In most dynamic and progressive economies, especially South East Asian economies (except for a few), there is no Long Term Capital Gains Tax. We should also abolish this tax and instead increase the holding period of shares from 12 to 18/24 months to be eligible for tax benefits so that genuine investors may not be hit by this regressive tax.



Alternatively, when proceeds from sale of shares which are held for more than 18/24 months are reinvested into some other shares, and the Securities Transaction Tax is paid on both the transactions, such proceeds should not be liable to attract Long Term Capital Gains Tax. To illustrate, if an investor has held shares of a particular company that is not performing well, for five years, then looking at the dull prospects of the company, if the investor wants to sell off these shares and reinvest the proceeds in a better performing company, under the present regime, he will be liable to pay Long Term Capital Gains Tax on the sale of the existing shares. This is detrimental for genuine investors whose objective is investment, and not trading. Therefore, there should be no Long Term Capital Gains Tax imposed on the sale of shares which are held for more than 18/24 months and sold due to meek prospects of the company, and the entire proceeds are reinvested into some other company.

### **Pre-Budget Expectations - Indirect Taxes**

# Mr. M.S. Mani, Partner, Deloitte India (Indirect Tax)

The Union Budget cannot make any announcements related to the GST law as this is the prerogative of the GST Council; however following are the expectations for various sectors:

- Simplification of Goods and Services Tax (GST)
- Gems and Jewellery:
- Reduction in existing rate of import duty on both gold and diamonds
- Reduction in import duty on polished diamonds to 2.5% from the current 7.5% and a cut in import duty on gold from 10% to 4%
  - Energy, Resources & Industrials Sector:
- Provide a roadmap for the stabilisation of the GST law highlight issues which will be addressed
  in the short term and provide a longer term plan as well.
- Provide some insight on when and how real estate and petro products especially CNG and PNG will be brought within GST.
- Share insights for administrative changes that are being considered for a better administration
  of the GST law.
- Share insights on how GSTN related issues will be addressed quickly.
- A portion of coal cess should be allocated as VGF for combining new wind/solar and existing gas based power plants to utilize LNG as this would improve usage of gas and also promote cleaner fuels replacing coal
- Budget allocation to be made for construction of north east pipeline which would connect the north east states to main gas grid and improve utilisation of gas in this eco-sensitive region.