# UNION BUDGET 2010-2011: "A *Populist, Aam Aadmi Budget"*

## HIGHLIGHTS & ANALYSIS

***The Union Budget 2010-11 turned out to be an all encompassing package which managed to balance the expectations of its audience and hence, was deemed to be pragmatic, progressive and prudent.***

***India's expectations of the Budget ranged from***

- ***Continuing the momentum of growth, economic development and rising rural incomes***
- ***Reduction in the fiscal deficit and moving towards fiscal consolidation***
- ***Reining the inflationary pressures***
- ***Being Reform Oriented***

## *Overview of the Budget*

### *Growth Consolidation*

- India is among the first few countries in the world to implement a broad-based counter-cyclic policy package to respond to the negative fallout of the global slowdown.

- Despite global slowdown, Indian economy has shown resilience and estimated to have grown at 7.2% in FY10. Indian economy is projected to grow at 8.5% in FY11 and move sooner to 9% plus trajectory in medium term. Industry growth (as measured in terms of Index of Industrial production) is expected to grow at robust 8-9% next fiscal.

- The Union Budget aimed to focus on inclusive growth and ensuring food security. Several new initiatives have been introduced for sustained and inclusive growth, to address the weaknesses in government systems, structures and institutions at different levels of governance.

- Expenditure has retained a focus on inclusive growth and infrastructure development, with 46% of the plan allocation devoted to infrastructure. Some of the sectors with substantially higher outlays in 2010-11 relative to revised estimates for 2009-10 include education, water supply & sanitation and housing.

- The increased budget allocations to rural programs will sustain the progress of the last few years. Increasing rural living standards and corresponding higher consumption spending will continue to be the key features of the Indian economy.

- After introducing the Direct Tax Code which is expected to be implemented from 1st April 2011, attempts are being made to further improve the investment environment by taking a number of steps to simplify the FDI regime. As a first important step, the methodology for calculation of indirect foreign investment in Indian companies has been clearly defined.

- The Budget also announced the revised date April 1, 2011 for the migration to the GST regime, which was keenly awaited. Additionally, the surcharge on domestic companies has been reduced to 7.5% from the existing rate of 10%. However, the same would be offset to some extent by the increase in the rate of MAT to 18% of book profits from the current rate of 15%.

- The Budget has extended the existing interest subvention of 2% for an additional year in order to boost exports, which have displayed positive growth in y-o-y terms since November 2009 after witnessing sustained contraction since the global economic crisis began in October 2008. The Budget also extended the 1% interest subvention on housing loans up to Rs.1 million,for houses with a cost under Rs.2 million to March 31, 2011, with should provide a further impetus to low cost housing.

- On the agricultural front, the Government shall adopt a four pronged strategy to spur growth. The elements of the strategy are (a) **agricultural production**; (b) **reduction in wastage of produce**; (c) **credit support to farmers**; and (d) **a thrust to the food processing sector**.

    - The Budget provides Rs.400 crore for extending the green revolution to the eastern region
    - 60,000 'pulses and oil seed villages' will be organized in rainfed areas with an outlay of Rs.300 crore during 2010-11.
    - This will provide water harvesting, watershed management and soil health facilities to enhance to productivity of dryland farming areas.
    - To improve the storage capacity of food grains, Food Corporation of India is being allowed to hire godowns from private parties for a guaranteed period of seven years. This period so far was five years.
    - The target for farm credit is being raised to Rs.3,75,000 crore in 2010-11 from Rs.3,25,000 crore in the current year.

- The period for repayment of loans under the Debt Waiver and Debt Relief Scheme is being extended by six months to June 30,2010.
- The interest subvention for timely repayment of crop loans is being raised from 1% to 2%. Thus, the effective rate of interest for crop loans for farmers who repay their crop loan as per schedule will now be 5% per year.
- Five more Mega Food Parks will be set up in addition to the 10 already being established. External Commercial Borrowings will henceforth be available for cold storage, farm level pre-cooling and preservation and storage of agricultural and allied produce marine products and meat.
- Moreover, the outlay for grants-in-aid to the State Governments is significantly higher than in 2009-10 reflecting the recommendations of the Thirteenth Finance Commission (

***Fiscal Consolidation***

- Fiscal prudence is back. The overall theme of the Union Budget for 2010-11 was a shift in fiscal policy from stimulating growth to maintaining the growth momentum while embarking on a renewed path towards fiscal consolidation.

- The Budget has aimed to achieve these dual objectives through a combination of selective rollbacks in the tax cuts to boost revenue receipts and controlled growth of revenue expenditure, and higher disinvestment proceeds to provide headroom for enhanced capital expenditure benefitting the infrastructure sector.

- The **revenue deficit**, which is estimated to have worsened to 5.3% in 2009-10, from 4.5% in 2008-09, is budgeted to improve to 4% of GDP in 2010-11 as a result of the estimated high growth of revenue receipts and controlled 6% growth of revenue expenditure.

- With the help of reduced non plan expenditure, the fiscal deficit has been contained at 5.5% of GDP for BE 2010-11. This forecasted improvement is largely on account of the expected improvement in the revenue deficit. The rolling targets for fiscal deficit are pegged at 4.8% and 4.1% for 2011-12 and 2012-13, respectively.

- With the reduction in the fiscal deficit, the **net market borrowing of GoI** in 2010-11 is lower at an estimated Rs. 3,450 billion, which is largely in line with market expectations. Restricting the fiscal deficit and the borrowing requirement of GoI would be crucial in order to avoid a considerable hardening of interest rates.

| With Fiscal Deficit at 5.50% | | |
|---|---|---|
| FY 11 | | Rs. Trn |
| | Gross Borrowing | 4.57 |
| | Maturities | 1.12 |
| | Net Borrowing | 3.45 |

- With Finance Ministry accepting the 13th Finance Commission report in toto, the Budget mentions that it will soon come out with the medium term plan for fiscal consolidation. **This and lowering of fiscal deficit to 5.5% of GDP in FY11 from 6.7% in FY10 clearly indicates the finance ministry's plan to bring down the fiscal deficit in phased manner over a period of time. This intention, if backed by actions, will have positive impact on sovereign rating.**

## *Impacts and Expectations on the Fixed Income Front*

- We expect the gross borrowings programme to be front-loaded like previous years. Assuming that 70% of annual borrowing is conducted in first half, G-Sec issuance numbers comes to around Rs. 3.2 trn. Despite huge maturities of 0.84 trn, net issuance might be still high at Rs. 2.36 trn.

**Expected G-Sec Issuance Schedule (Amt in Rs. trn)**

| Share | | Gross Borrowing | Maturities | Net Issuances |
|---|---|---|---|---|
| 70% | H1 FY 11 | 3.1999 | 0.84 | 2.359 |
| 30% | H2 FY 11 | 1.371 | 0.3 | 1.071 |

- **Given the still high government borrowing we expect g-sec yields to harden from the current levels with the 10 year benchmark expected to trade in the range of 8% to 8.50% in the 1H FY11.**

- On inflation front, **we expect the inflation to peak by March at around 10% level on domestic demand revivals, high food prices and base effect. Thereafter, it is likely to remain around 7% level by September end** on rising manufacturing prices and unfavorable base effect (Inflation was close to zero in 1H FY10 with June through Aug posting negative growth). Post September, we expect the inflation to decline and be around 4% level by next March end helped by improved manufacturing capacities and base effect (Inflation jumped from 1.46% in Oct'09 to 8.56% in Jan'10).

- **Credit growth is likely to pick up further and be around 20-22% on demand pick-up and high base effect.**

- In an attempt to control higher inflation **RBI might keep benign liquidity conditions** by using instruments like OMO, MSS and other monetary measures like CRR hike. In light of the above **the shorter end rates are expected to gradually rise from current levels**.

- **Indian economy is expected to grow 8.5% in FY11 on assumption of normal monsoon**. The **robust economic growth will result in credit-pickup**. Although the current credit growth is low at 15%, we expect **the credit growth to accelerate and be around 20-22% next year** helped by domestic demand as well as base effect (credit growth declined from 18% in Apr'09 to 9% in Oct'09).

- Higher demand for funds in a growing economic scenario will also result in increased supply of bonds both at the PSU as well as private corporate level. **Corporate bonds are expected to follow G-secs with yields rising from current levels. The 10 year AAA corporate bonds yield is expected to rise from 8.90% to around 9.25%-9.50% levels.**

**The stock market witnessed a rare Budget rally – the first time in four years – boosted by the government's pledge to cut fiscal deficit, but concerns about rising inflation and interest rates tempered the mood.**

## *Sector-wise Impact & Analysis*

### *Infrastructure: Focus remains for key economic development*

- **44% of total plan outlay allocated to infrastructure** - Budget allocates Rs 1.73 lakh cr for infrastructure.
- **IIFCL to double disbursement & refinance.**
- Delhi-Mumbai industrial corridor taken up for development.
- **Road transportation kitty increased 13% to Rs 19,894 cr .**
- Government allocates Rs 16,500 cr for railways.
- **Rs 66,100 cr allocated for rural development in FY11.**
- 35% of development funds to be invested in rural India.
- **Urban development allocation up more than 75% to Rs 5,400 cr.**
- **Allocation for Bharat Nirman at Rs 48,000 cr .**

- **Additional Rs 20,000 tax deduction available for investment in long term infrastructure bonds.**
- **Government committed to SEZs to promote exports.**
- **Full exemption from import duty for specified machinery for road construction projects.**

***Real Estate – Encouraging affordable housing***

- The construction period for real estate builders to avail benefits under section 80-IB (10) has been extended to 5 years from 4 years.
- **Rs.12.70 billion has been allocated for Rajiv Awas Yojana for slum dwellers, up from Rs.1.50 billion, an increase of 700% with the aim of creating a slum free India.**
- Rs 100 billion have been allocated for Indira Awas Yojana.
- **Interest subvention scheme for home loans extended till March 2011.** Under the scheme, home buyers get 1% interest subsidy for loans up to Rs 1 million, provided the cost of house does not exceed Rs 2 million.

***Power Sector gets a boost: FM doubles allocation***

- **Allocation to the power sector has been doubled to Rs 5,130 core in Budget 2010.**
- **Announcement to form Coal Regulatory Authority -** The move will help expedite the process of allocation mining resources to consuming firms.
- **Solar energy also found a special mention in the Union Budget.** The government proposes to establish a national clean energy fund and is targeting the setting up of 20,000 MW of solar power by 2022.

- Increase in allocation to renewable energy sector at Rs. 1000 Cr (increase by 61%)
- Increase in available long-tem funding through refinancing from IIFCL.
- Clean energy cess of Rs. 50/MT on both domestic and imported coal.
- Excise duty on photo-voltaic and solar panels has been waived while central excise on LED lights have been cut to 4%.

***Banking & Financial Services: Budget 2010 aims to improve growth prospects***

- **RBI to consider giving banking licenses to Private Sector Companies / NBFCs.**
- **GoI to recapitalize Public Sector Banks** by Rs 165 billion to maintain Tier -1 ratio above 8% by FY11E end – Infusion of capital to improve capital adequacy of banks.
- Regulatory framework for the financial sector to be strengthened: Apex level financial stability & Development council to be set up.

- **Increase in interest subvention from 1% to 2% for the farmers who pay as per repayment schedule**.
- Extension of debt waiver and debt relief scheme for farmers extended by six months to June 30, 2010.
- **GOI's focus on financial inclusion** through introducing/improving financial service penetration & focus on rural budgetary allocations would improve the growth prospects of financial service sector.

***Oil & Gas Sector: Low on Reforms, High on Taxes***

- **Continue to provide oil subsidy in cash instead of bonds** – The industry expected a clear subsidy-sharing mechanism of cash subsidy/oil bonds and clarity on tax breaks for natural gas produced under NELP I-VII.
- **To discuss Kirit Parikh report in due course -** The sector expected de-regulation & an in increase in fuel and gas prices. There were hopes that some of the recommendations made by the Kirit Parikh committee would see light of the day. However, no such measures were announced in the Budget.
- **Oil exploration & production companies would be hit by increase in MAT from 15% to 18%**
- Restoration of basic customs duty of 5% on crude petroleum, 7.50% on petrol and diesel and 10% on other refined petroleum products
- Enhancement of central excise duty on petrol and diesel by Rs. 1/litre each.
- Post budget announcement of hike in petrol and diesel prices by Rs. 2.67/litre and Rs. 2.58/litre respectively.

***Auto Sector: FM's realistic moves provide an easy breathing***

- Hike in excise duty from 8% to10% – Would benefit companies with tax haven operations.
- Excise duty on large cars, SUVs, multi utility vehicles raised to 22% from 20%.
- **Implementation of GST would prove to be beneficial for auto companies.** The GST aims to bring other taxes like excise, VAT, CST and other taxes under one umbrella and the GST rate may be lower than the combined total of the current taxes.
- **Another minor positive for auto companies is the weighted increase in research and development (R&D) exemption from 150% to 200%.**
- **Allocation for road development increased by 13% to Rs. 198.94 billion** – Continued thrust on rural India will further improve demand for 2 wheelers, cars and LCVs.

### *Healthcare – Continuous support for higher investments by research led Pharma companies*

- Increase in budget allocation for the Ministry of Health and Family Welfare from Rs.195.34 billion in FY2009-10 to Rs.223 billion for FY2010-11.
- **Increase in weighted reduction from 150% to 200% on expenditure incurred on in-house R&D activities and from 125% to 175% on activities outsourced to specific institutions**
- Uniform, concessional basic duty of 5 per cent, CVD of 4 per cent with full exemption from special additional duty on all medical equipment
- Exemption provided to specified inputs for the manufacture of orthopedic implants from import duty.

### *Education – Focus on inclusive development*

- **Plan allocation for school education increased by 16 per cent from Rs.26, 800 crore in 2009-10 to Rs.31, 036 crore in 2010-11.**
- In addition, States will have access to Rs.3, 675 crore for elementary education under the Thirteenth Finance Commission grants for 2010-11.

## *Tax Implication*

With the new Direct Tax Code with its sweeping changes being made applicable from next year, one really could not see the government ringing in big ticket changes on the taxation front for all of just one year in Budget 2010. The Finance Minister’s budget speech removed whatever little doubt that remained. As it transpires, Budget 2010 holds very little for the common man except for relaxation in tax slabs. The following are key highlights.

### *Significant Benefit Offered in Respect of Personal Income Tax*

The proposed new rates are as follows:

| Income | Tax Rate |
|---|---|
| Up to Rs. 1,60,000 | Nil |
| Rs. 1,60,001 to Rs. 5,00,000 | 10% |
| Rs. 5,00,001 to Rs. 8,00,000 | 20% |
| Above Rs. 8,00,000 | 30% |

The enhanced basic exemption limits for ladies of Rs. 1,90,000 and for senior citizens of Rs. 2,40,000 remain unchanged.

### *Tax Benefits for different income slabs*

| Income Level | Old Slabs | New Slabs | Difference |
|---|---|---|---|
| **Male** | | | |
| 4,00,000 | 35,020 | 24,720 | 10,300 |
| 6,00,000 | 86,520 | 55,620 | 30,900 |
| 8,00,000 | 1,48,320 | 96,820 | 51,500 |
| **Female** | | | |
| 4,00,000 | 31,930 | 21,630 | 10,300 |
| 6,00,000 | 83,430 | 52,530 | 30,900 |
| 8,00,000 | 1,45,230 | 93,730 | 51,500 |
| **Senior Citizens** | | | |
| 4,00,000 | 26,780 | 16,480 | 10,300 |
| 6,00,000 | 78,280 | 47,380 | 30,900 |
| 8,00,000 | 1,40,080 | 88,580 | 51,500 |

### Tax relaxations apply only to higher income group

As can be seen from the above table, everyone who earns an income of above Rs. 8 lakh would pay a lower tax of Rs. 51,500. However, what about the lower income group? Those who earn a taxable income of up to Rs. 3,00,000 have been totally ignored! They stand to gain nothing. Earlier they paid a tax of 10% on income above Rs. 1.60 lakh and with the revised slabs too, they continue to do so!

### *Saral II on the anvil*

- To call the new income tax return forms (that replaced the erstwhile Saral) complicated would be an understatement. However soon, taxpayers (at least the salaried class) can look forward to a two page simple and user friendly tax return form. Since this is just an announcement by the FM in his speech, when exactly will these forms be issued and to which category of taxpayers (apart from the salaried) is yet not clear. The income tax department should be coming out with a notification in this regard.

### *New Tax Deduction for investment in infrastructure bonds*

- The good news is that Budget 2010 has proposed a new Sec. 80CCF that will offer a deduction of up to Rs. 20,000 next year onwards for investment made in infrastructure bonds. The still better news is that this Rs. 20,000 is over and above the Rs. 1,00,000 Sec. 80C limit. The details as to the term of these bonds, the lock-in period, the issuing institutions etc. are yet to come out.

***NPS (New Pension Scheme)***

- The NPS has not taken off as expected. Now the Government proposes to contribute Rs.1,000 per year to each NPS account opened in the year 2010-11. This initiative, "Swavalamban" will be available for persons who join NPS, with a minimum contribution of Rs.1,000 and a maximum contribution of Rs.12,000 per annum during the financial year 2010-11.

***Disallowance of expenditure on account of non-compliance with TDS provisions***

- The existing provisions of section 40(a)(ia) of Income-tax Act provide for the disallowance of expenditure like interest, commission, brokerage, professional fees, etc. if tax on such expenditure was not deducted, or after deduction was not paid during the previous year. It is proposed that no disallowance will be made if after deduction of tax during the previous year, the same has been paid on or before the due date of filing of return of income Note that this amendment is proposed to take effect retrospectively from 1st April, 2010.

***Tax Audit limits increased***

- Under the existing provisions of section 44AB, every person carrying on business is required to get his accounts audited if the total sales, turnover or gross receipts in business exceed Rs. 40 lakh. Similarly, a person carrying on a profession is required to get his accounts audited if the gross receipts in profession exceed Rs. 10 lakh. These limits have been increased to Rs. 60 lakh and Rs. 15 lakh respectively.

***Change in gift tax provisions***

Under the existing provisions of section 56(2)(vii), any sum of money or any property in kind which is received without consideration or for inadequate consideration (in excess of Rs. 50,000) is taxable in the hands of the recipient. Of course, receipts from relatives or on the occasion of marriage or under a will are outside the scope of this provision. Nonetheless this law is only applicable to an individual or an HUF.

Therefore, transfer of shares of a company to a firm or a company, instead of an individual or an HUF, without consideration or at an inadequate consideration escapes the tax net completely. In order to prevent the practice of transferring unlisted shares at prices much below their fair market value, it is proposed to amend section 56 to also include within its ambit transactions undertaken in shares of a company either for inadequate consideration or without consideration where the recipient is a firm or a company

Also, in several cases of immovable property transactions, there is a time gap between the booking of a property and the receipt of such property on registration, which results in a taxable differential. It is, therefore, proposed that Sec. 56 will only apply if the immovable property is received without any consideration and to remove the stipulation regarding transactions involving cases of inadequate consideration in respect of immovable property.

### *Tax Summary*

As you can see, for the average investor, Budget 2010 was largely a non-event. Even the relaxations in personal income taxes pale when seen in light of what is proposed next year onwards in terms of the Direct Tax Code (DTC). For example, under the DTC, an income up to as much as Rs. 10 lakh will be taxed only @10%, income between Rs. 10 lakh and Rs. 25 lakh will be taxed @20% and the 30% rate would only be applicable to incomes above Rs. 30 lakh.

Speaking of which, it was expected that Budget 2010 may create some basic groundwork for the introduction of the DTC. Its been a while since the DTC has been put in the public domain and various stakeholders have already indicated their feedback to the government. However, there is no word on any developments on this front. There have been representations that the government should re-look at proposed provisions in the DTC such as taxing NRIs at a flat rate without offering the basic exemption limit, taxing all capital gains without any exception, scrapping of Sec. 54EC bonds, canceling the interest deduction on home loans, applying EET on existing investments etc. However, Budget 2010 chose to remain silent. It is hoped that there is some intimation in this regard from the government during the year. Watch this space for any developments.

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