

2019 BUDGET EDIT

Good start in parts, timid in many ways

Good NBFC-fix, no tax reform & numbers iffy; just plans on power, labour etc for now



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GIVEN THE MANDATE prime minister Narendra Modi just won, and his own interpretation of that as a message from a country that yearned for change, it was natural to expect his government's first budget—also finance minister Nirmala Sitharaman's maiden one—to be one with sweeping reforms aimed at tackling India's big problems of slowing investment and growth. Not surprisingly, Sitharaman has tried, with some success, to get a fix on some of the major pain points. Her bigger success is that she has outlined a roadmap of reforms.

She had an innovative solution to India's Lehman+ crisis with, not just IL&FS, but other NBFCs like DHFL also in trouble. Taking them over was fraught with moral hazard, so she gave banks a credit guarantee to buy up to Rs 1 lakh crore of NBFC assets—with an assurance the government would absorb the first loss of up to 10% of their value—and has slowly brought them under the ambit of RBI as they should always have been. Similarly, she has promised measures to deepen the bond market—this will also address a systemic flaw in how NBFCs raised money so far—and possibly even set up a dedicated financial institution for infrastructure.

Given how the power sector remains fragile despite the Uday reforms package, the FM promised a slew of deeper reforms over the year, came up with an imaginative solution like asset recycling and joint development to use government/PSU land to build housing...And while such plans will necessarily take a long time to fructify, the proposal to use PPP to complete railway tracks, manufacture of rolling stock and running freight trains should boost investor sentiment fairly quickly since railway minister Piyush Goyal is known for his efficiency in delivery. As in the past, the budget has aggressive targets for infrastructure creation like roads and railways; outlays have risen 15% for railways and 12% for roads.

What is not clear, in this context, is why the budget had so little by way of an agriculture reform roadmap, more so considering how agrarian distress has been such a big issue over the past few years. An ideal road map should have laid out a policy to increase direct cash-transfers such as under PM-KISAN and a reduction in subsidies like those on fertiliser that are mostly consumed by the rich. Indeed, the budget needed to announce a phaseout of MSP-based procurement and a move towards a free market, with PM-KISAN transfers being increased. What this suggests is that the PM's advisors have convinced him the MSP-based model is working well and just needs some tweaking.

Modi's immediate post-victory comment on how India just had two castes—the poor and those who wanted to help the poor—should have prepared people for a higher tax on the better off. If it didn't, it is because, at the same time, there was talk of reducing India's tax levels to those in competitor countries; India has among the highest level of corporate taxes in the world. What the tax bureaucracy has ensured, however, is a mish-mash. So tax rates on those earning over ₹2 crore a year have been raised to 39% and to a whopping 42%+ for those earning over ₹5 crore. While that sounds like what some European nations charge, keep in mind the tax rate for firms with a turnover of less than ₹400 crore is 28%—in other words, this will encourage tax arbitrage while the sensible thing is to reduce tax differentials.

While the budget has done well to broadly stick to the fiscal roadmap, this could be iffy. FY19 saw a huge slippage in tax revenues on GST and income taxes. For reasons best known to the government, the FY20 budget hasn't used the lower tax numbers for FY19 that have been reported by the finance ministry's CGA wing. Once you use those, the required tax growth in FY20 is a challenging 18.3% and not the 9.5% the budget speaks of. In which case, if taxes fall short, the government may have to slash expenditures at the end of the year or increase extra-budgetary borrowings; both will hurt GDP recovery.

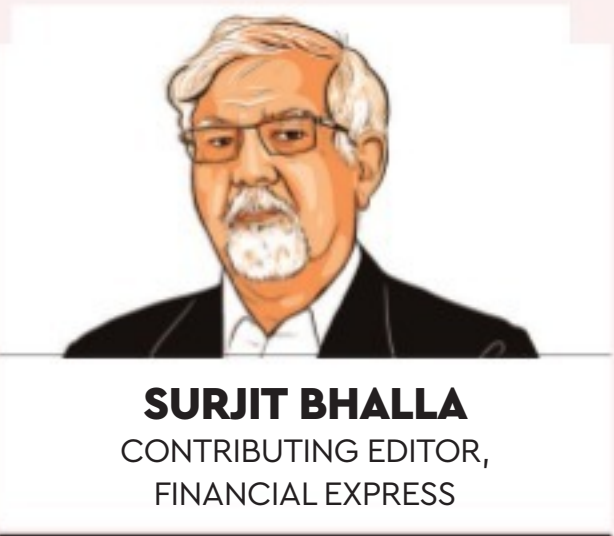
And while the Economic Survey was at pains to explain that India's tax and other policies were creating 'dwarves', or firms that never grew, and that big firms contributed more to jobs and GDP growth, tax rates on large firms remain unchanged. The FM said that 99.3% of firms now pay just a 28% tax, but it is the 0.7% of firms that create the most value. While India's labour laws are another pain point for investors, the FM has promised to handle this through four labour codes. There is, however, no timeline given as to how soon these will be passed in Parliament; keep in mind the codes have been in the works for several years now.

The finance minister's dramatic step up in disinvestment is welcome, but what is not clear how much of this will come from privatization since that is what brings about real change in the ways PSUs are run. The FM has said strategic sales continue to remain a priority for the government but if this means, as it did in the past, an ONGC buying an HPCL or an LIC buying an IDBI Bank, that is not going to enthrone investors. As in the past, the PM seems unsure about embracing sweeping market-based reforms; the economy can't grow at 8% if he doesn't sometime soon. Despite the FM extolling the virtues of wealth-creation, several of the government's policies remain fairly anti-industry.

Time too short for big power, telecom etc reform, but why wait to hike FDI in media or aviation? Capex won't get a boost till all the plans work out

Future Budgets should be like this one. No longer an accounting statement like past Budgets

FM came, (almost) conquered

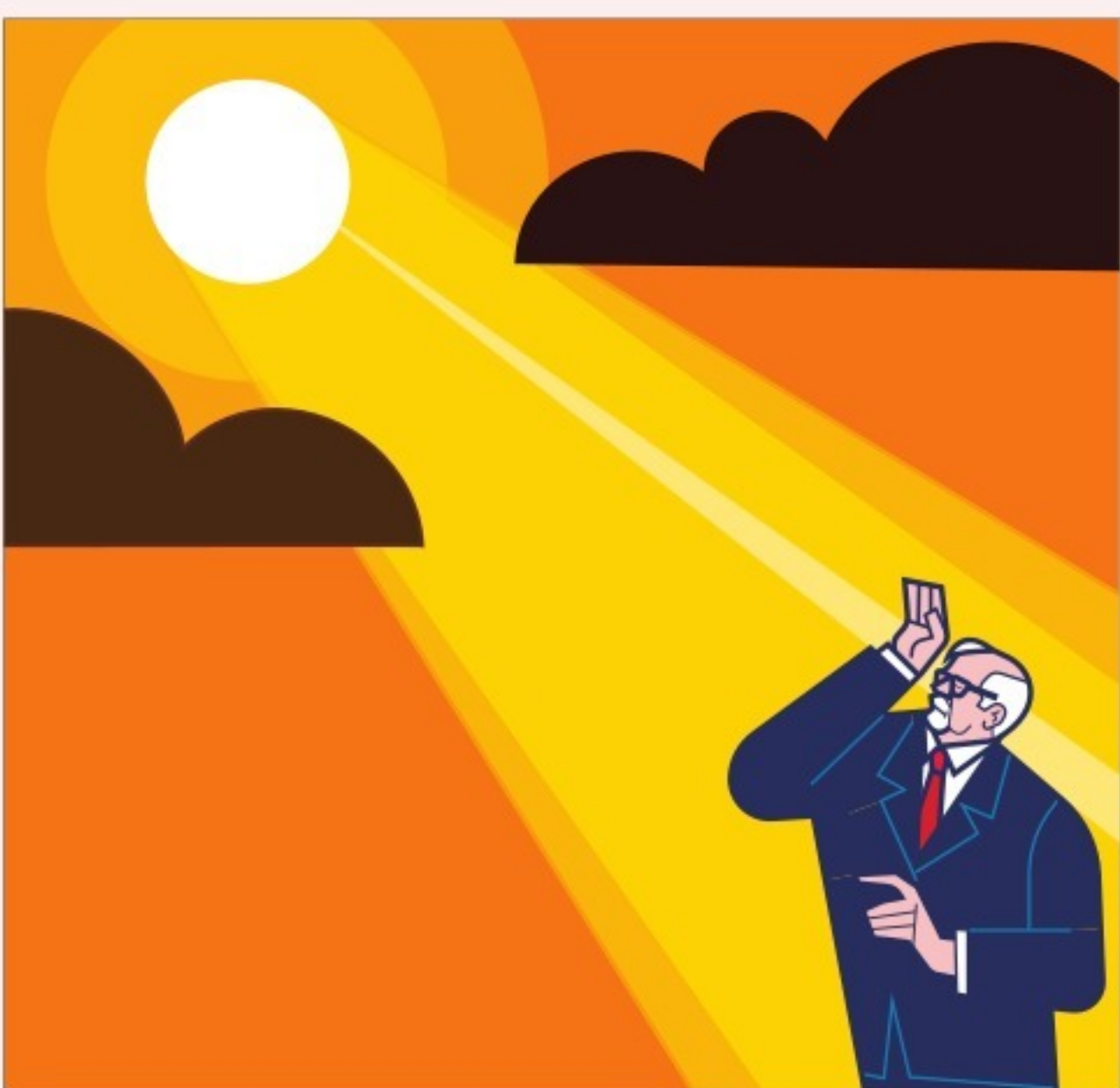


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BUDGETS USED TO be an accounting statement—and Finance Ministers indulged their favourite industrialists to reveal who was favoured and who was not. Excise taxes went up for those the FM's wanted to punish, and down for those they wanted to encourage. Then came GST. Now, 18 months old, and with the GST council making all the decisions, there is precious little for the FM to do on indirect taxes. We await the finalisation of the direct tax code; until then, the budget can tinker around (this time more than tinker) with corporate tax rates and individual tax rates. The good news was that the corporate tax rate was reduced from 30% to 25 % for all but 0.7% of firms. Why not all firms is a question everybody is asking.

And, then, there was the tinkering with income taxes and surcharges on the super-rich—call it an (unsuccessful) balancing act to the reduction of the corporate tax rate or to the fact that tax authorities still have not graduated from their increase tax rate and get lower tax revenue axiom of the Indira Gandhi era. So, bowing to Piketty, the tax rate for the super-rich was increased, via an increase in the surcharge to near 40%, a rate last observed before the Dream tax budget of 1997.

How much extra tax revenue would



SHYAM KUMAR PRASAD

the MoF get from this exercise? Don't ask embarrassing questions, but likely the same amount they got from imposing the long-term capital gains tax, i.e., a tax loss rather than a tax gain. Why? Because tax avoidance (a favourite Indian habit) creeps in and absolutely fewer super-rich people will accurately report their super-rich incomes. And, given that the highest corporate tax rate is 28% (25+3% surcharge), there will now be a 12 ppt gap between the corporate tax rate and the rate for rich individuals. Likely the largest such gap observed in the world today. With the very predictable consequence of individual incomes going down and corpo-

rate income going up. And total direct tax collection going down. This underlies the urgency of reaching a direct tax code, so the FM's hands are tied (like they are for indirect taxes). So, this budget may be the last one for tinkering of direct taxes.

But all is not lost for those wanting to "intervene". The budget of the future, likely next year, will be one where the only tax rates being tinkered with will be custom duties. For example, the present Budget imposed a 5 % custom duties on imported books. Most of us want to believe that such purchases should be subsidised, especially since the Budget (correctly) laid emphasis on education

and the National Research Foundation. The total value of imported books (children picture books, etc, harmonised code of 4901) in 2018-19 was \$154 million or .03 % of total imports. At a 5% tax rate, that will yield tax revenue of ₹54 crore.

But, that is where the bad news ends. Besides these guffaws (and maybe a few others I missed), Sitharaman's Budget speech was what budget speeches will be—a vision statement of what the government plans to do. She set the tone of her speech in an honest and direct manner. She was presenting the Budget because the BJP had achieved overwhelming support and mandate. She emphasised the build-up of the foundation of equality—infrastructure, water, sanitation, housing, power, roads—and women empowerment. The provision of these public goods are the essence of good governance, and what inclusive growth is all about.

Future budgets should be like this one, no longer an accounting statement like past budgets. Accounting should be left to accountants or accounting economists. Thankfully, the FM presented the fiscal deficit as an afterthought; at 3.3% for 2019-20, down marginally from the Interim Budget estimate of 3.4%. The implied nominal GDP for 2019-20 is a 12% increase over 2018-19. Even if nominal growth is 11%, this would mean that the fiscal deficit will be at the originally budgeted 3.4%. Revenues are budgeted to increase by 13.5%—even with slippage on both revenues and GDP, the likely fiscal deficit will be 3.5% of GDP. Finally, and thankfully, such small differences in fiscal deficits are not only not a talking point, but also, at best, a footnote.

We await the future, perhaps as early as February 2020. One can't expect a Budget to be a perfect statement of intent and vision. But, Sitharaman's premier Budget statement was a good start.

Setting the pace for NDA-II

All reforms considered, this Budget has been a valiant effort by Nirmala Sitharaman



TV MOHANDAS PAI, CHAIRMAN, AARIN CAPITAL PARTNERS

IN KEEPING WITH Modi government's focus on upgrading the quality of life for *Aam Aadmi*, the Budget has continued its programmes to ensure all have access to the bare necessities by 2022. There has been significant spending on improving social living conditions, with a focus on housing, water, power, health, gas stove, sanitation, etc. There will further be investments to the tune of ₹100 lakh crore to improve infra over the next five years. These are crucial endeavours for 'Reform, Perform, and Transform India' vision.

Higher education has received particular focus, which is good to see. The proposed National Education Policy will help groom and retain top talent. The creation of the National Research Foundation is timely. The quality of higher education has not taken enough strides in the past years, due to lack of quality research output. Higher Education Commission will provide greater autonomy to institutes, and will increase focus on better academic outcomes.

Amongst the widespread reforms, the

most prominent are in the financial sector. In a sluggish growth environment with international overhang, Public Sector Banks (PSBs) have been given a capital boost of ₹70,000 crore. For the purchase of high-rated pooled assets of NBFCs up to ₹1,00,000 crore, the government will provide a one-time six months' partial credit guarantee to PSBs for first loss of up to 10%, easing the credit chokehold on small businesses post the NBFC crisis last year. Building a larger corporate bond market will increase access to low-cost capital, helping drive investment-led growth.

In a bold and impressive step, Sitharaman will initiate a sovereign borrowing programme from external markets in external currencies, which will bring much-needed liquidity, and buoy consumption. Easing norms for FDI in aviation, media, and insurance sectors, and simplifying the KYC

process for FPIs were much needed, propelling up disinvestment opportunities and inflow of external capital.

Digitisation continues to be a priority, with an effort to curb off-the-books cash payments in business transactions. There is a stark contrast in the way the government focuses on detaching dishonesty in tax payments while also penalising honest taxpayers with incomes over ₹2 and ₹5 crore with surcharges of 10% and 15%, respectively.

An important topic that needed more focus was creation of quality jobs. While creating jobs and improving farmers' incomes is certainly important, it is equally important to understand India's demographic trends, well-outlined in the Economic Survey. Good quality long-term jobs will be developed in sectors showing healthy growth. The focus should be more on growing India's

large companies and promoting new-age technology start-ups.

The angel tax was harassment; the FM has committed to remove this from AIF Category I & II investors. However, this cannot be a benefit. To promote investments and growth, investors must be incentivised. Such high-risk, low-liquidity investors cannot be taxed the same way as stock market investors, who leverage low-risk, high-liquidity conditions. Bringing down capital gains for such investors from 20% to 10% will promote the growth of a healthy ecosystem and create better paying long-term jobs. This has been overlooked.

There is overhaul of complications arising from the 44 labour laws by consolidating them into four labour codes. This will bring down compliance costs for businesses and improve the formalisation of labour, helping bring wage parity.

All reforms considered, this Budget has been a valiant effort by Sitharaman; she has addressed most issues India faces today.

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The great disconnect

The world changes, but you wouldn't know it from India's budget



JAHANGIR AZIZ, MD & CHIEF EMERGING MARKET ECONOMIST, JP MORGAN

SINCE THE FEBRUARY interim budget, the global economy has changed dramatically. We now know that the US-China trade tensions have not only had a much larger direct effect on both countries and those connected to the China supply chain but also its indirect impact, via dampening business sentiment, has been so large that global capital spending is now tracking its lowest in several years. Notwithstanding the assurance made by both China and the US in the recent G-20 meeting to return to negotiations, the languishing of global investment has forced many analysts and major central banks to lower growth forecasts and prepare for a potentially sharp economic slowdown. From the Fed to the ECB, almost all central banks, including those in India and other emerging market economies, even those with large current account deficits, are planning to provide substantial policy support to keep growth

a float. In India, the economic situation isn't any better: last quarter's official growth rate, at 5.8%, was the lowest in five years, while the NSS's estimated unemployment rate is at a 45-year high.

But you wouldn't know this from reading the Budget. The lack of any meaningful discussion on the changing global environment or the slowdown in activity in India was glaring by its absence. Consistent with this view, the budget stuck to its interim deficit target in rupee terms, which implied a marginal lowering as a share of GDP from 3.4% to 3.3%. Not that I am complaining. Sticking to the deficit target was the right thing to do, but for entirely different reasons than I suspect the government believes in. Even with a lower deficit at 3.3% of GDP, the total public sector borrowing (including off-balance sheet funds) is likely to remain around 8.5-9% of GDP. This by itself is higher than the financial savings of households at 6.5% of GDP. Consequently, the public sector is already

eating into corporate savings and any material recovery in investment would also mean higher foreign borrowing, and, in turn, a higher current account deficit.

The slowdown in India is not cyclical. If one simply charts India's investment and exports as shares of GDP from the 1990s, the two lines are virtually indistinguishable. This correlation is the same for most emerging economies. Global trade has been the life blood of emerging markets, just as it has been for India. Private investment in India has floundered not because funding costs are too high or banks are hamstrung with bad loans or the exchange rate is too appreciated, as is collectively bemoaned. It is because global trade has languished since 2012 and is unlikely to recover to its past pace with the maturing of supply chains and the rise of anti-globalisation politics. Fiscal policy does have a role, but it is to restructure taxes and spending to encourage new domestic growth engines, not to increase the deficit.

Separately, the Budget pushed for greater reliance on foreign funding to relieve the current liquidity pressures on the domestic capital market and the government is now looking to issue foreign currency bonds. This is a remarkable departure from India's long-standing policy of avoiding the "original sin". Issuing dollar-denominated government bonds will be successful, but it is unlikely to raise overall foreign funding. The buyers of local and foreign currency bonds are the same investors. With the government taking on the currency risk, these investors would be more than willing to shift to dollar bonds by selling their holding of local-currency bonds. Prior to the 2013 Taper Tantrum, India's authorities also encouraged foreign funding by increasing the approval of external commercial borrowing (ECB) by corporates. We know how that story ended. Cannibalising the local-currency bond market and taking on currency risk isn't a prudent strategy in today's risky global environment.

2019 BUDGET

OPED

PM-KISAN should have been expanded to cover fertiliser and power subsidies

Farming with PM-KISAN



ASHOK GULATI
INFOSYS CHAIR PROFESSOR FOR AGRICULTURE AT ICRIER

IN HER FIRST budget speech, the Union finance minister Nirmala Sitharaman reminded us of the famous quote of M. K. Gandhi that the ‘Soul of India lives in villages’. She also said that for *Gramin Bharat*, her focus is on ‘*Gaon, Garib, and Kisan*’. She spelt out certain schemes, but the overall focus was on strengthening infrastructure through PM’s Gramin Sadak Yojana (PMGSY), making *Ammadata* also an *Urja-data* (i.e., converting farmers into producers of solar power), strengthening e-NAM, focusing on fisheries through Matsya Sampada Yojana, etc. She also reiterated the PM’s promise of supplying piped water to every home by 2024, while reminding that 1,592 blocks in the country are critical and over-exploited.

These are all laudable steps in the right direction, although one will have to see how they are achieved in due course. One notable thing in the various schemes announced for agriculture was the absence of emphasis on doubling farmers’ real incomes by 2022. Maybe, reality has dawned on the government that this is an uphill task, and they may not achieve even half the target. So, no more echoing of that.

But to know the real action in agriculture, one has to see the expenditure budget for Ministry of Agriculture and



Farmers’ Welfare, which has jumped from ₹67,800 crore in 2018-19 (revised) to ₹1,30,485 crore for 2019-20, (budgeted), a jump of more than 92%. And, this is mainly coming from PM-KISAN, which jumps from ₹20,000 crore to ₹75,000 crore. This is the biggest policy shift, a move towards direct income transfer, which was an election promise. As far as other schemes are concerned, there is a marginal change, and nowhere near PM-KISAN. There are no significant reforms or strategies announced for boosting agriculture and farmers’ incomes.

The most disappointing thing is that allocation for agri-R&D has remained

almost constant. The budget for the Department of Agriculture Research and Education (DARE) is kept at ₹8,078 crore compared to ₹7,953 crore for 2018-19 (revised). This is less than even one global company’s expenditure, say, Bayers’, on agri-R&D. The Economic Survey had highlighted that India spends only 0.37% of agri-GDP on agri-R&D. The global consensus is that developing countries need to spend at least 1% of agri-GDP on agri-R&D if they want to raise productivity sustainably and ensure food security, as also augment farmers’ incomes. The rate of return from agri-R&D is one of the highest. The neglect of this agri-R&D will haunt India in the years to come. Already,

the rate of growth of agriculture exports in the first five years of Modi government has been negative! So, the whole talk of doubling agri-exports in five years, or even doubling farmers’ incomes by 2022, sounds empty in the face of such low expenditures on agri-R&D. Without continuous research, and augmenting productivity, the competitiveness of Indian agriculture will soon be lost.

There is, however, talk of zero-budget agriculture. Organic is fine for the niche markets, but for mass production at low cost, it is Science. One wonders whether Modi 2.0 is anti-science and anti-R&D?

Since PM-KISAN is the main flag march in agriculture, one would have expected some fine tuning of it and expanding it to cover fertiliser subsidy, and even a hint to bring power subsidy under it. But nothing has happened on any of these fronts. Fertiliser subsidy has gone up from ₹70,000 crore to about ₹80,000 crore. The pending bills of about ₹30,000 crore of fertiliser industry remain as they were, demoralising the fertiliser industry.

On the irrigation front, the situation remains alarming. Despite highlighting 1,592 blocks being overexploited in 256 districts, the budget for PM Krishi Sinchayi Yojana, though up by 17%, remains minuscule at ₹9,681 crore. This is not enough to take care of the irrigation needs of agriculture or promoting efficient use of water. Within this PMKSY, the per drop, more crop scheme is budgeted at just ₹3,500 crore, way below the needs.

With all of this, if there is no big push towards agri-research (read better and high yielding seeds), any rationalisation of fertiliser subsidy, and with meagre investments in water, what shall be the future of Indian agriculture and millions of farmers dependent on it? It does not augur well for India’s peasantry. Is it that PM-KISAN is cutting down on much-needed investments and agri-R&D?



ARUNDHATI BHATTACHARYA EX-CHAIRMAN, STATE BANK OF INDIA

A bankable budget

Bank interoperability is a new paradigm, let’s what the government intends to do

A LOT WAS expected of this budget, and the question being hotly debated is how far it came up to expectations. Well, coming from the banking and financial space, I must say that this space had more of its wishes fulfilled than many others. The government gave a clear signal of its commitment to support both Public Sector Banks as well as Non-Banking Financial Companies. Could it have gone further? Of course, it could, but what has been done is not small by any means. While there have been many voices against recapitalisation of banks, I would say that this is probably one of the best steps that could be taken, because banks can leverage this infusion in the best possible way to improve credit flow to the economy. And, improving credit flow is one of the basic requirements if we need to step up economic activity in the country in order to shift gears for higher growth.

The finance minister Nirmala Sitharaman has also, in passing, referred to more banking reforms to come. My hope is that this will indeed happen, and

I think there are already media reports of the regulator beginning deliberations about the holding company structure. I do not posit that this is the magic bullet to cure the issues faced by public sector banks, but it is an incremental step in the right direction. Banks are in the service sector, and the requirement of the right kind of Human Resources cannot be overemphasised. This is difficult in the current setup, and the sourcing of the right kind of specialised manpower remains a major challenge. Towards this end, the holding company structure would be a great enabler—creating a far more level playing field for PSBs.

A commitment was also made to enable customers of these banks to be served at the counters of any Public Sector Bank. This is a new paradigm, and we need to find out what the government intends to do in this area. Does it mean creating a common platform on which

all banks log on, as do their customers? That is indeed a radical thought and difficult to envisage. While creating a platform may, indeed, help weaker players for whom technology spends could be a challenge, for the larger banks, it could mean loss of competitive advantage.

However, there was already talk about account portability, and therefore, one needs to be ready for disruption of any shape or colour that may occur.

Turning to the NBFCs, there was indeed a sound signal about the government’s support of the sector with the proposal of a first loss guarantee to banks purchasing asset pools from NBFCs. But, more important than this is the move to empower RBI more in the regulation of NBFCs, and shifting the regulation of housing finance companies (HFCs) to the more experienced hands of RBI. It would be great now if the RBI exercised these powers to bring more clarity in the quality of the NBFCs.

Nothing is more dampening than uncertainty and nothing more dangerous than innuendos and rumours. We need to move past these by sorting the wheat from the chaff as early as possible. Those that are good need to return to business as usual. Those that need strengthening have to be given a roadmap so that they proceed in an orderly manner to do so. The problem can and must be overcome. It is the need of the hour, and if we are to lessen the stress on the small borrowers and SMEs that depended on these NBFCs, we must ensure an orderly process for the same. In a further welcome move, the RBI has already followed up the budget announcements with its announcement of allowing additional lending to NBFCs by Banks against their FALLCR requirements. There was also a line allowing foreign investors to invest in debt papers issued by NBFCs. This should be welcome as the sector revives.

All in all, material steps have been taken in this sector. We now look forward to the finer details and the execution of these plans to determine what impact these will finally have.

Material steps have been taken. We now look forward to the finer details and the execution of these plans



SAJJID Z CHINOY, CHIEF INDIA ECONOMIST, JP MORGAN

From intention to execution

The budget skillfully navigates tough macro backdrop. Appropriate execution must now follow

THE FIRST BUDGET of the government’s second term was always going to be a delicate balancing act. The growth momentum in India—and indeed, around the world—has slowed markedly in recent months. And, there was no space for a fiscal stimulus, as some had clamoured for. The broader public sector is already eating up virtually all household financial savings. Bond yields have finally witnessed a rally in recent weeks. Any widening of the fiscal deficit would have reversed those gains, pushed up interest rates more generally, and thereby undermined the efficacy of the RBI’s monetary easing cycle. How, then, should the government have tried to boost growth, investment and savings without any fiscal latitude?

Given difficult constraints, the budget is well-intentioned and hits all the right chords. But, the key is going to be execution.

The devil will, eventually, lie in the details. First, let’s talk about the intentions. There is a concerted effort to attract foreign capital to augment declining domestic financial savings. Increasing FDI limits in insurance, aviation and media are on the anvil. Domestic sourcing requirements for single-brand retail are expected to be eased; FPIs will now be allowed to invest in REITs and InVITs, and KYC norms for FPIs are expected to be rationalised. Authorities may float a dollar bond to access a broader international investor base. With some caveats, these are welcome moves. In a world of low and negative interest rates, with capital desperately searching for productive use, seeking foreign savings to augment domestic savings is understandable.

The area that deserves the most immediate attention is the financial sector. Credit markets for NBFCs are frozen, PSBs have the liquidity but not the growth capital, private banks are stretched to their limits with ris

ing credit-deposit ratios. Here, too, the government has tried to strike the right note. PSBs will be recapitalised by another ₹70,000 crore; some of this will hopefully translate into growth—and not just resolution—capital. On the NBFC front, a temporary and partial credit-guarantee will be offered to PSBs to purchase high-rated pooled assets from “financially sound” NBFCs, to inject liquidity and break the logjam.

Eschewing the clamour for a stimulus, the government has shown admirable restraint by pegging the deficit at 3.3% of GDP.

All told, the budget appears well-intentioned on fiscal discipline as it tries to unclog the financial sector and attract foreign capital flows. But, intentions apart,

much will depend on execution. Take fiscal math, for example. To achieve the fiscal deficit target, gross tax revenues need to grow at an ambitious 15% over last year’s actual outturn, even after adjusting for tax rate increases for high-income individuals and excise/custom duty increases. To put this in context, gross taxes grew at less than 9% last year. Therefore, unless growth rebounds sharply and/or GST collections are tightened meaningfully, tax targets are going to remain under pressure all year long, with questions about expenditure having to be addressed again at the end of the year.

Disinvestment targets are higher, but questions linger. Will the approach be true strategic sales/asset recycling to the private

Public sector banks will be re-capitalised by another ₹70,000 crore, and some of this will hopefully translate into growth—and not just resolution—capital

sector, which is more efficient at operating them? Or will one government arm simply buyout another? Will asset sales fund more public investment, or simply cover for tax shortfalls, akin to selling the family silver to pay the credit card bill?

On the financial sector, bank recapitalisation is positive. But only if (i) the allocation of capital is meritocratic, to ensure incentives and monies are aligned; and, (ii) bank governance reforms (read PJ Nayak Committee Report) proceed in tandem. Capital without reforms risks engendering another PSB NPA crisis down the line. On the NBFC front, there is a fine line between ensuring illiquidity does not spawn insolvency crisis and stoking moral hazard. The credit guarantee should be temporary and very targeted. And, if this does not work, one cannot ignore the long-run fix anymore: an asset quality review.

On the external front, attracting foreign capital is well and good. But, FPI flows are

notoriously fickle and pro-cyclical—elusive when needed. They can temporarily substitute for boosting domestic savings. While the sovereign dollar bond could attract a new class of investors, it risks cannibalising existing FPIs that hold Rupee assets. As small issuance in international markets may not materially change things, but if FPIs are willing to hold Rupee assets, why not further liberalise and induce FPI flows into the domestic market so that they—not the sovereign—bear the currency risk? What we don’t want over time is a dollar bond in international markets, without control of policymakers, disproportionately impacting domestic yields, as investors eventually arbitrage across the two markets.

All told, the budget has performed an artful balancing act against a difficult macro backdrop. The big themes—financial, external, fiscal—are all well-intentioned. Now, the authorities must walk the talk with equal skill.

Tax proposals & transparency

Focus on ‘Minimum Government and Maximum Governance’



MUKESH BHUTANI
PARTNER, BMR LEGAL ADVOCATES

THE FIRST BUDGET OF Modi 2.0 was announced with a huge focus on redistribution of wealth and tax administrative reforms keeping transparency in mind to support its slogan ‘Minimum Government and Maximum Governance’. It focuses on measures to simplify tax administration with the use of technology tools for tracing cash economy and reigning discretion of tax officials on tax assessments.

Incentives to start-ups: FM’s announcement for start-up sector on waiving the need for any form of scrutiny by the tax administration concerning ‘valuations’ of share premiums will come as a big sigh of relief for a sector which underwent an unwarranted examination of the taxman. Start-ups have now been dealing with challenges involving high credit costs and deprivation of timely adequate funding, adding up to complex regulatory gridlocks. Preventing government from achieving policy objectives under its flagship programs ‘Digital India’ and ‘Startup India’. Currently, India has over 16,500 start-ups as recognised by the Department of promotion of Industrial and Internal Trade from around 30,000 start-ups. Also, special administrative arrangements have been put in place for assessments of start-ups with prior approval of a senior official to undertake scrutiny assessment. Further, the issue of establishing the identity of the investor and source of his funds will be resolved by putting in place a mechanism of e-verification. Finally, the benefit of non-justification of the fair market value of shares will extend to Category-II Alternative Investment Funds (AIF) to proper funding in this sector.

These changes have primarily cleared the angel tax controversy over valuations during various rounds of start-up funding. The Bill proposes to extend the period of exemption of capital gains arising from the sale of residential house for investment in start-ups up to MAR 31, 2021 and transfer of majority shareholding of eligible start-up shall no longer be deprived from setting off its losses, which otherwise applies to all taxpayers.

Let’s see if the maximum marginal rate, at 42.74% is corrected with a moderate tax rate under the DTC

Other amendments: FM announced to introduce Central Cell to issue scrutiny notices to taxpayers. Notices will not disclose the name, designation or location of the Assessing Officer. Cases selected for scrutiny shall be randomly allocated to assessment units. The Central Cell will be a single point of contact between the taxpayer and the department. This new scheme of assessment represents a paradigm shift in the functioning of the revenue department and will discourage unfair practices.

In place of a levy for withholding tax, a 2% charge on withdrawal of cash in excess of ₹100 million from a single bank has been introduced to discourage the use of cash as well as establish a trail.

An introduction of two additional slabs of surcharge of 3% and 7% applicable to individuals on income between ₹20 million to ₹50 million and above ₹50 million, respectively, is motivated by the principle of redistribution of wealth via tax levies. Perhaps, the expectation on the streets for new levies, such as wealth tax and inheritance tax, is avoided with such super-rich tax. Of course, one needs to see if the maximum marginal rate, which stands at 42.74% is corrected with a moderate tax rate under the Direct Tax Code. As an anti-avoidance measure, buyback of listed shares will be taxed at 20%, which was earlier applied only to unlisted companies.

At the outset, it is fair to say that this year’s Budget is primarily focused on tax administrative reforms with a vision to encourage a cashless economy to come close to the distant dream of \$5 trillion GDP by 2024-25.