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BUDGET 2020 SECTION 2

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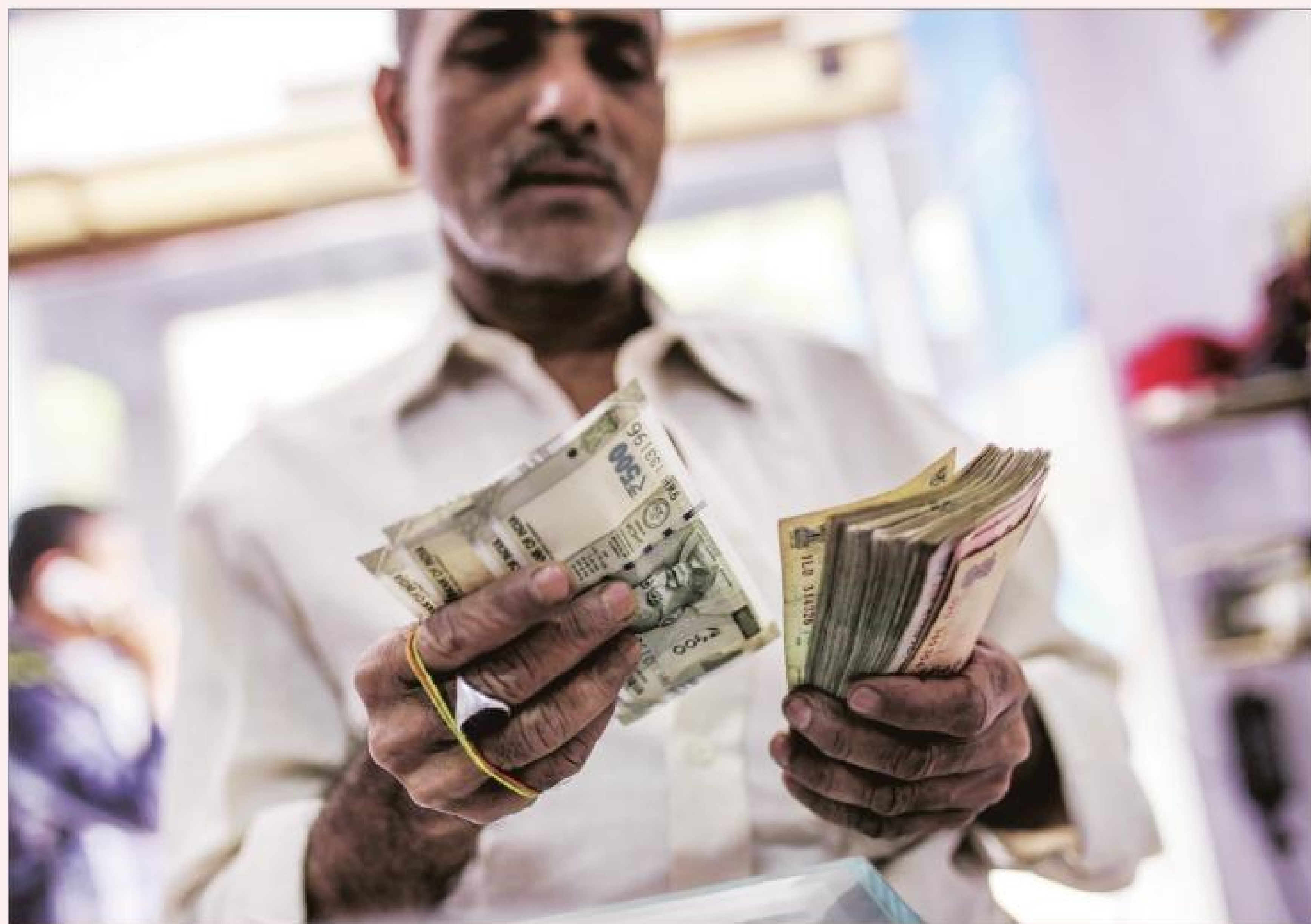
DOES FINANCE MINISTER KNOW HER ONIONS?

ACROSS THE AISLE

P CHIDAMBARAM



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THE PRESIDENT'S ADDRESS, the Economic Survey and the Budget are three documents—also opportunities—to spell out the government's policies and goals.

Leaving other matters aside, I looked in the President's Address for signals on how the government intended to tackle the grave economic slide. I found none.

I turned to the Economic Survey. This year it has a new helmsman, Mr KV Subramanian. He seems to love Tamil verse as much as economics. The central theme is that wealth-creation is good and wealth-creators must be respected. It is an idea that is no longer novel or controversial. The sole challenging chapter in the Survey is the one on how government intervention in markets hurts more than it helps but, the next day, the finance minister royally ignored the advice! She also ignored all other recommendations on structural reforms.

Let us now look at Budget 2020-21. I intend to assess the Budget—numbers, speech and proposals—under three heads: marksmanship, underlying philosophy and reforms.

Poor marksmanship

So many things have been done, under pressure, after the last Budget was presented in July 2019, it is unfair to hold the FM to the budget estimates (BE) of 2019-20. Yet, it must be recorded that she failed on a number of heads:

- Against a projected growth of GDP of 12% (in nominal terms), the GDP will grow by only 8.5% in 2019-20. The estimate for 2020-21 is 10%.
- Against a BE of 3.3%, the fiscal deficit will be 3.8% in 2019-20 and projected to be 3.5% in 2020-21.
- Against an estimated net tax revenue collection of ₹16,49,582 crore, the government will be able to collect only ₹15,04,587 crore before the end of March 2020.
- Against a disinvestment target of ₹1,05,000 crore, the exercise will yield only ₹65,000 crore this financial year.
- Against the intent to incur a total expenditure of ₹27,86,349 crore in 2019-20, the government will spend only ₹26,98,552 crore despite additional borrowing of ₹63,086 crore.

No underlying philosophy

It is a matter of grave doubt if the BJP government has an underlying economic philosophy at all. One has to glean its philosophy from the numerous acronyms that were thrown at the people in the last six years. Basically, their guiding principles appear to be self-reliance, protectionism, control, bias in favour of traders (as against producers and consumers), aggressive taxation and faith in government expenditure.

Did Budget 2020-21 signal a change in the thinking of the government? The answer is 'No'. In fact, the FM did not spell out her government's thoughts on the macro-economic crisis faced by the country. Nor did she say if her government thought the slump was due to structural factors or cyclical factors. It appears that the government continues to be in denial; the government is in denial that the economy is demand-constrained and investment-starved. Being in denial, the government has refused to look at serious reform measures or propose solutions to the twin challenges.

The government's idea of 'reforms' is to give small dollops of tax relief to tax payers. It was the corporate sector a few months ago; in this Budget, relief of ₹40,000 crore has been given to personal income tax payers. The FM also yielded to the pressure of the corporates and scrapped the Dividend Distribution Tax. There is no gainsaying the fact that DDT was an efficient tax and stopped all evasion of tax on dividend income. I am certain there will be loss of revenue on abolition of DDT.

In the bargain, the FM has introduced two tax regimes (one with exemptions and one without exemptions) and complicated the personal income tax structure with multiple rates—the same mistake the government made when it introduced GST.

Giving up on reforms

The FM outlined three themes and under each theme there were several segments and many programmes. For example, under the theme Aspirational India, she identified three segments, and under each segment she announced many programmes. In the same vein, she devoted nearly an hour to elaborate on the other two themes—Economic Development of All and Caring Society. When she was done, I lost count of the number of themes, segments and programmes. Listening to the speech and reading the text later, I did not find anything that would amount to a structural reform in any sector. I wonder what happened to the labours of the Chief Economic Adviser.

On the other hand, I remember the claims that the FM made with a straight face:

1. We have lifted 271 million people out of poverty during the period 2006-2016.
2. We will double the farmers' income by 2022.
3. Swachh Bharat is a great success and the whole country is open defecation free.
4. We have taken electricity to every home.
5. We will make India a $5-trillion economy by 2024 (although the ES has stealthily pushed the deadline to 2025).

The take-away from the Budget speech and the Budget numbers is that the BJP has given up on reviving the economy or accelerating the growth rate or promoting private investment or increasing efficiency or creating jobs or winning a greater share of world trade.

So, brace yourself for an economy that will limp along at an unsatisfactory growth rate in 2020-21. I know you did not deserve it but, I am afraid, that is what you got yesterday.

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The SOP story for startups continues

ESOPS, OR EMPLOYEE Stock Option Plans, are a means to reward employees of companies with equity in the company. In India, ESOP schemes such as the ones created by Infosys, have helped create over 18,000 millionaires.

However, India's ESOP taxation regime has been designed for listed companies and not for startups. In India, ESOPs are taxed twice— first they are taxed as income from salary (perquisite) at the point of exercise, as the difference between the grant price (price at which the ESOPs are offered to employees) and the fair market value (taken as price of most recent round of funding due to our tax laws); at the point of sale, they are taxed again as income from capital gains.

The tax at the point of exercise is a tax on notional gains, but paid out in form of hard liquidity. Given the high delta between fair market value and grant price, the economic outflow is considerable and employees can't sell these shares, as startup securities are illiquid. This leads them to taking loans to pay their taxes to become shareholders—a dismal state of affairs.

SIDDARTH PAI
FOUNDING PARTNER, 3ONE4 CAPITAL

India can ill afford to sacrifice the golden goose of startups at the altar of adverse tax policies

Countries such as China, Singapore or the US allow the Board to adopt the 'liquidation value' of the ESOPs as their fair market value or even defer taxation to point of sale. Employees of listed entities can sell their shares on the stock market, allowing them to pay their taxes from the liquidity generated. But employees of Indian startups aren't afforded these considerations and the latest changes don't add to this either.

If one reads the fine print of the Finance Bill 2020, under Section 156, there exists a pernicious insertion in the form of a qualifier for a startup to avail of this—the startup should be recognised by the IMB (inter-ministerial board), a government body that certifies a startup as 'innovative'. Of the over 50,000 startups in India, only about 27,000 are registered with DPIIT; of these, only a fraction have received IMB certification due to the process.

Even for IMB-certified startups, the only difference is that the tax payable is deferred, but the liability is fructified at the point of exercise. If the company collapses, or if it is sold at a loss, then the tax liability calculated as per the slab rates at the point of exercise is still payable, even if the employee loses money on the sale. The only change is a timing and cashflow issue, not a change in the fundamental issues plaguing ESOP taxation in India. The tax payable at the point of exercise is independent of the tax payable at the point of sale. If the employee loses money at the point of sale, tax at the point of exercise is still applicable.

The dismay amongst entrepreneurs is palpable. Some feel cheated by the Budget and the volte-face in the Finance Bill, and others are dismayed by the efforts made to rectify this. Even the 'super-rich surcharge' of 25% and 37%, which was rolled back on listed securities, still remains on unlisted securities and ESOPs—further penalising startup employees.

It is unfortunate that the tax piece has remained the Achilles heel of startup India—be it angel tax, which is yet to be fully exorcised, the riders placed to get a tax holiday or this change in ESOP taxation. While other government departments have done tremendous work in opening up to startups, the tax department still treats them as subordinate to their listed counterparts. India can ill afford to sacrifice the golden goose of startups at the altar of such adverse tax policies.

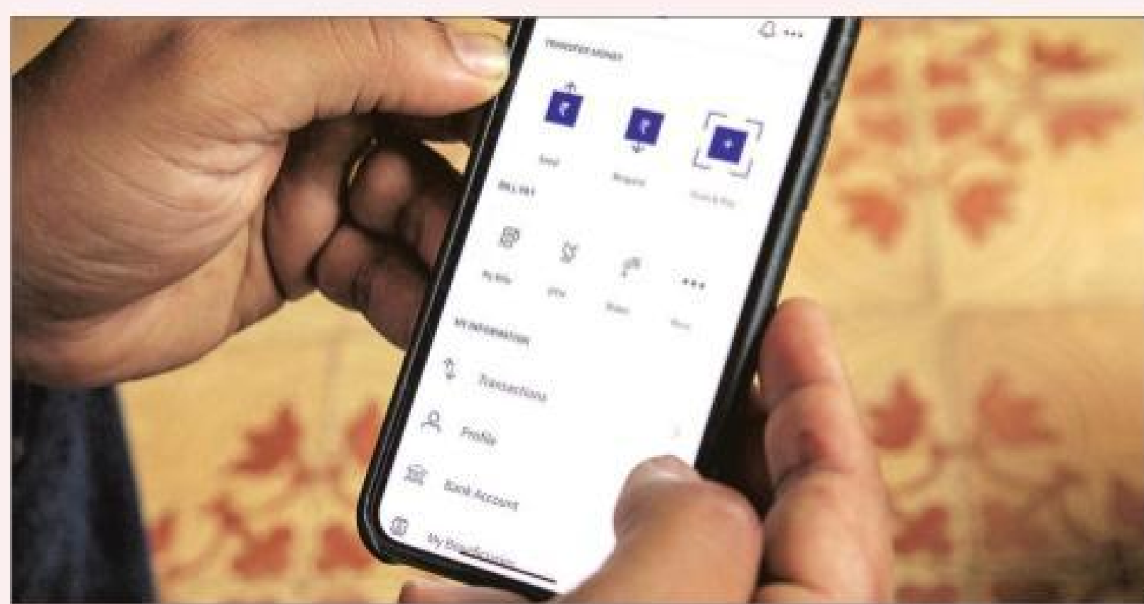
Dismal state of affairs

Taxed as	When	Determination of liability	Rate
Income from salary	Point of exercise	Fair market value less grant price	Normal slab rates (with 'super-rich surcharge'*)
Income from capital gains	Point of sale	Sale price less fair market value	Short-term—normal slab rates (with 'super-rich surcharge'*) Long-term—28.5% (with 'super-rich surcharge'*)

*as applicable

Thumbs up for made-in-India mobiles and electronic items

KIRAN RATHEE



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THE ANNOUNCEMENT FOR creating a scheme to encourage manufacturing of mobile phones, electronic equipment and semiconductor packaging in the country has gone down well with the domestic industry.

Laying the ground for such measures, the Budget also increased customs duty on certain items like printed circuit board assembly (PCBA), chargers, display panels, vibrator or ringer of mobile phones. Customs duty on PCBA has been doubled to 20%, while a 10% duty has been levied on vibrator/ringer of mobiles and display panel and touch assembly. The duty on chargers and power adapters have also been increased to 20% from 15% now.

FM Nirmala Sitharaman said electronics manufacturing industry is very competitive and India has shown its cost advantages. "The potential of this industry in job creation is immense. India needs to boost domestic manufacturing and attract large investments in the electronics value chain."

Prashant Singhal, emerging markets TMT leader, EY, said, "Increase in import duty of mobile phone components such as display panel, touch panel, microphone, receiver and printer-circuit will ensure further Indianisation of products and increased intensity of production in India. With national electronic policy in force, the Budget is in sync with the endeavour to target manufacturing of one billion indigenous mobile handsets, 60% of which is likely to be for exports and promote domestic manufacturing in the value chain of electronic system design and manufacturing to achieve $400 billion by 2025." Singhal said the proposed incentives for manufacturing of mobile phones, electronic equipment and semiconductor packaging will be a big push toward establishing India as a global manufacturing hub, not only to serve local consumption, but to export worldwide given the cost benefits.

The Economic Survey has also highlighted the success story of mobile phone assembly in India. India toppled Vietnam to become the second-largest manufacturer of mobile phones globally, following China, in 2018 with a world share of 11%.

For mobile handsets, the government, under the national policy on electronics, 2019, had set a target of making 100 crore mobile handsets locally by 2025, valued at about ₹13 lakh crore. As per Indian Cellular and Electronics Association, which counts Apple, Xiaomi, Foxconn, etc, as its members, the proposed scheme will create the necessary momentum to build the $190-billion mobile phone industry with exports of $110 billion, as envisaged in NPE.

Industry body MAIT said the emphasis on mobiles, which account for the largest import bill in electronics, is welcome. "The government needs to include IT, datacom, medical and other sub-sectors of electronics. While the scheme is still in the works, this will result in rise in exports from India," Nitin Kunkolienker, president, MAIT, said.

ICEA chairman Pankaj Mohindroo also welcomed the introduction of Section 28DA in the Customs Act, which proposes that preferential tariff treatment can be suspended in cases where importers do not fulfill obligations imposed on them and also where time-bound verification from the importing country is not forthcoming.

Education gets higher impetus, but lower allocation of funds

ISHAAN GERA

- Govt allows FDI and ECB route for higher education funding
- Only a marginal increase of 4.7% in budgeted expenditure
- Skill programme gets 19% more funds

INDICATIONS OF OPENING the education sector is good news for the economy. The FM, in her Budget speech, said, "Steps would be taken to enable sourcing external commercial borrowings and foreign direct investment (FDI) so as to deliver higher quality education," in a softening of stance towards the idea of foreign universities. But there is still a long way to go if the country is to attract any university. Given the stringent conditions in the sector—the government only wants a Harvard or Stanford—it may be impossible to attract anyone until the government relaxes norms. Same is the case with external commercial borrowings, which, as the government puts it, is required to achieve "greater inflow of finance to attract talented teachers, innovate and build better labs".

Willingness is, undoubtedly, a big step, but unless the government specifies rules under which this can be allowed and does not make the process bureaucratic by asking to funnel funds through its bodies, the efforts to reform education would be for nought. Education institutions, at present, as per a Ficci-KPMG white paper, generate ₹15,000 crore of surplus annually, which can only be invested in certain places. Unless the government allows institutes freedom over control of their funds, they will not be able to raise money from the market.

Given that the government's expenditure in terms of education has been dwindling, it is undoubtedly the need of the hour. The government has been claiming that education is its top priority, but budgetary allocations do not indicate this. Indeed, while the budgeted amount for FY21 has increased to ₹99,311.52 crore, the quantum of increase has reduced drastically as compared to last year. While the revised estimates for FY20 highlight an 18.1% increase in allotment for primary, secondary and higher education over the FY19 numbers, the budgeted figures for the next fiscal only show a 4.7% increase. Despite the government claiming to improve the quality of higher education, Budget numbers indicate that growth in expenditure here has declined from 21% last year to a mere 3% in FY21.

The government has increased allocations for the skill development programme, allocating ₹3,002 crore for the ministry, an increase of 19%, but it has little to show in terms of skill development over the last few years. Of the over one crore persons it was targeted to train since 2016 under three different programmes under PMKVY 2.0, by the ministry's admission, it was able to enrol only 69 lakh, of which 66 lakh got trained, and only 50 lakh got certified. What's more is that only a meagre 15 lakh—one-fourth of those trained—ended up with jobs.

Apprenticeship programmes and use of engineering freshers as interns for urban local bodies will undoubtedly address these constraints. But more compelling is the government's proposal to allow 150 higher educational institutions to start apprenticeship-embedded degree/diploma courses in March 2021.

In the medical sector, an old demand of allowing linking of district hospitals with medical colleges is a positive step, as it will create more seats and also address the issue of shortage of doctors.

While the government has announced online learning by extending such benefits to top 100 institutions in the NIRF rankings, unless it implements the new education policy, there is little chance much would change.