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EDITORIAL

BUDGET 2007

CA VINOD JAIN *

The UPA Government has presented its 4th budget in parliament on 28th February, in the backdrop of economic growth of 8.5% per annum on an average during the last 3 years. The growth rate is completely un-precedent. The industrial sector as well as the service sector growth rate has crossed l1% per annum. The matter of concern is poor growth in the agricultural sector of only about 2.7% during the last 5 years. The plan proposals of the government to provide necessary irrigation facilities, warehousing facilities, better seeds and technology for a better agricultural growth has so far not shown any result. The agricultural credit has grown significantly and has reached to the level of 2,25,000 crore. This increase in credit will not contribute to growth unless it is utilized for creating genuine capacities, and for providing better technology. Another green revolution is necessary, failing which economic growth cannot be sustainable and the inflationary pressure on agricultural commodities is further likely to hit the common man.

Resource Crunch and Debt Trap

The net collection of tax by the Government is projected at Rs. 403,872 crore during 2007-08. Against this, a sum of Rs. 4,21,219 crore has been estimated for repayment of debt and interest burden on the debt. The fresh borrowings of the Government have been projected at Rs. 371,803 crore and net of repayment more than 1.5 lakh crore. Incremental debt is being obtained to meet various budgetary requirements. **The Government needs to a significantly deep debt restructuring and one time settlement plan and in any case has to commit no further borrowings at any cost.** The tax collection of the Government has already gone up by more than 100% in last 3yrs and in spite of such a heavy doss of taxation, the Government is unable to meet its liabilities and to have adequate resources for planned growth. The planned capital investment has been budgeted only to the extent of Rs. 30476 crore during 2007-08. This is only 4.47% of the total budgetary expenditure during the year. Unless the Government is able to allocate larger resources for planned capital expenditure, the infrastructure sector including power sector, roads, ports, rural telecom, airports, irrigation and education sector cannot be looked after adequately and appropriately.

Rising Interest Rates

The interest rates have recently gone up very significantly both on deposit as well as on advances. This may have an adverse impact on economic growth and economic viability on small and medium size industries.

Employment

The employment front is still dismal and unless large rural population is provided employment opportunities in agriculture, agro industries and small and medium size manufacturing sectors by public-private partnership, the number of unemployed youths will keep on increasing.

Vocational Training

The plan to develop 1396 Industrial Training Institutes (ITI's) as Centers for Excellence is a good idea. The vocational and specialized training has to become very effective and have a larger reach in view of substantial shortage of adequate qualified and trained manpower in industrial sector as well as in service sector.

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DIRECT TAXES

1.0 TAX RATES

1. Income Tax threshold exemption limit raised by Rs. 10,000 for individuals / HUFs.
2. Consequently, exemption limits would be:
   - Basic Limit - 1,10,000
   - Woman Assessee - 1,45,000
   - Senior Citizen - 1,95,000
3. Surcharge of 10% (2.5% in case of foreign companies) on SMEs having income upto Rs. 1 crore removed
4. Corporate Tax Rates remain unchanged
5. Dividend Distribution Tax raised from 12.5% to 15% for Corporates
6. Dividend Distribution Tax for Money Market Mutual Funds and Liquid Funds raised to 25% on dividends paid to all investors.
7. Education cess raised from 2% to 3%

2.0 EXEMPTION / DEDUCTION REMOVED

- Scope of MAT extended to cover Income exempted under section 10A and 10B i.e. such income would now be included in computation of Book Profits under section 115JB
- Capital assets to include personal effects like archaeological collections, drawings, paintings, sculptures and any work of art. Transfer of any such asset to attract capital gains tax.
- Deduction under section 36(1)(viii) available to certain companies in respect of amount transferred to a Special Reserve to be restricted to 20% of profits each year.

3.0 EXEMPTION / DEDUCTION EXTENDED

- Pass-through status to be granted to venture capital funds only in respect of investments in venture capital undertakings in biotechnology; information technology relating to hardware and software development; nano technology; seed research and development; research and development of new chemical entities in the pharmaceutical sector; dairy industry; poultry industry; and production of bio-fuels, and hotel-cum-convention centers of a certain description and size. Consequently, definition of Venture Capital Undertaking under section 10(23FB) amended to include only such units, which are engaged in the above mentioned activities.
- Deduction for Medical Insurance under section 80D raised by Rs. 5000. Payments now can be made by any mode other than Cash.
- Benefit under section 80IA for infrastructure facilities extended to include
  - Cross country natural gas distribution network, including gas pipeline and storage facilities integrated to the network
  - Navigation Channel in sea
- A five year income tax holiday for two, three or four star hotels and for convention centres with a seating capacity of not less than 3,000 beginning operations in National Capital Territory of Delhi or in the adjacent districts of Faridabad, Gurgaon, Ghaziabad or Gautam Budh Nagar during April 1, 2007 to March 31, 2010
- Tax holiday to undertakings in Jammu & Kashmir to be extended for another five years up to March 31, 2012
- Weighted average deduction under section 35(2AB) for inhouse research and development to be extended for five more years until March 31, 2012
- Now deduction u/s 80E for interest paid on loan taken for higher studies will be allowed even if such loan is taken for higher studies of spouse and children.
- Any cash payment in excess of Rs. 20,000/- for any expenditure claimed in the computation of income, will be disallowed in full and treated as income of the assessee. However the CBDT will prescribe the circumstances under which such cash payment can be made and claim as deductible expenses.

4.0 TAX DEDUCTED AT SOURCE

- Individuals and HUFs also to deduct tax u/s 194C on amounts paid to Work Contractors, if such individual or HUF's turnover exceeds the limit specified u/s 44AB
- Rate of deduction of Tax on payment of commission or brokerage increased to 10% u/s 194H.
- Rate of tax deductible at source on rents payable for hiring of machinery, plant u/s 194 I or other equipments reduced to 10%.
- Rate of tax deductible at source on sums payable for fees for professional services or technical services u/s 194 J or other equipments increased to 10%.
- Exemption Limit of Rs. 5000 raised to Rs. 10000 for deduction of tax u/s 194 A on interest earned on Fixed Deposits with banking Company, Co-operative Society engaged in banking business and Post Office under notified schemes.
- TDS shall be deducted on 8% (Taxable) Savings Bonds, 2003, if interest payable in a financial year exceeds Rs. 10,000 u/s 193.

All TDS related amendments will take effect from June 1, 2007.

5.0 TAX COLLECTED AT SOURCE

Any contract or lease in respect of mining and quarrying shall not include mining and quarrying of mineral oil and hence not attract provisions of tax collection at source under section 206C. Mineral would include petroleum and natural gas.

6.0 FRINGE BENEIT TAX

- Expenditure on free samples and on displays to be excluded from the scope of Fringe Benefit Tax (FBT)
- Employee's Stock Option Plan (ESOP) brought under FBT.
- Payment of Advance Tax on Fringe Benefits and due dates for the same have been aligned with the provisions of advance tax on income as specified u/s 211 of the Act. This implies that now assessee will have to compute/estimate fringe benefit value on yearly basis and pay the advance tax thereon as specified u/s 115WJ of the Act.

7.0 BANKING TRANSACTION TAX

- Exemption Limit for Banking Transaction Tax for Individuals and HUF's raised from 25,000 to 50,000
- Cash withdrawals by Central and State Governments to be excluded from the scope of Banking Cash Transactions Tax.

8.0 OTHERS

- As a step to simplify the tax regime in respect of Gem and Jewellery business, A benign assessment procedure to be introduced for assessees engaged in diamond manufacturing and trading who declare profits from such activities at 8% or more of turnover
- Limit of Rs.50 lakh per investor per year with respect to capital gains bonds issued by NHAI and REC under section 54EC to continue
- The scope of income received by Non-residents in respect of royalties / fees of technical services has been expanded by way of insertion of explanation in section 9 with retrospective effect from June 1976.
- Direction for Special Audit u/s 142(2A) cannot be ordered unless the assessee is opportunity is given to defend his case. Further cost of audit is to be paid by the central government instead of the assessee.

INDIRECT TAXES

1.0 GENERAL

- A Secondary and Higher Education Cess @ 1% has been imposed on Customs Duty and Excise Duty as well as Service Tax.

2.0 SALES TAX

Central Sales Tax rate to be reduced from 4% to 3% with effect from 1st April 2007.

INDIRECT TAXES

3.0 EXCISE DUTY

- No change in general CENVAT rates.
- Basic exemption limit for SSI raised from 1 Crore to 1.5 Crore.
- Water purification devices, Bio-diesel, Water Carrying pipes with diameter exceeding 200mm to be fully exempted from duty.
- **Rates Increased :**
  - Duty on cement costing more than Rs. 190/- per bag increased from Rs. 400 per metric tonne to Rs. 600 per metric tonne.
  - Additional duty raised by 5% on cigarette.
- **Rates Reduced :**
  - Petrol and Diesel - Existing Rate 8%, New Rate 6%.
  - Footwear and Umbrella - Existing Rate 16%, New Rate 8%.
  - Plywood - Existing Rate 16%, New Rate 8%.
  - Pan Masala not containing Tobacco - Existing Rate 66%, New Rate 45%.
  - Cement costing less than Rs. 190/- per bag - Existing Rate 400 per mt, New Rate 350 per mt.

4.0 CUSTOMS DUTY

- Peak Rate for non-agricultural produce reduced from 12.5% to 10%.
- Rates of duty on various items reduced
  - Chemicals Plastics- Existing Rate 12.5%, New Rate 7.5%.
  - Seconds and defectives of steel - Existing Rate 20%, New Rate 10%.
  - Coking coal - Existing Rate 5-10%, New Rate Nil.
  - Polyester fibers, yarns and on raw materials - Existing Rate 10%, New Rate 7.5%.
  - Cut and polished diamonds - Existing Rate 5%, New Rate 3%.
  - Synthetic Stones - Existing Rate 12.5%, New Rate 5%.
  - Medical equipment - Existing Rate 12.5-5%, New Rate 7.5%.
  - Pet food - Existing Rate 30%, New Rate 20%.
  - Watch dials and movements - Existing Rate 12.5%, New Rate 5%.
- All edible oils, crude as well as refined oils, roasted molybdenum ore and concentrate to be exempted from additional duty of 4%.

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BUDGET 2007...

Commodity Trading

The Government has announced ban on trading of wheat, rice, urdh and toor dal from being traded on Commodity Stock Exchanges, in the backdrop of substantial increase in prices of agricultural commodities. The commodity exchanges as well as storage and hoarding has to be regulated in an appropriate manner to curb the malpractices on one hand and permitting free movement and storage of commodities, subject to regulatory guidelines.

Education

The education cess has been increased from 2% to 3%. This amount is required to be directly spent on creation of new schools, education material and for provision of teachers and other necessary educational infrastructure. The quality of education is also a matter of concern in the midst of reports that in certain rural areas even the 8th Std. students are not able to answer 2nd Std. Questions.

Bharat Nirman

The Government has allocated larger resources towards growth of education and health but considering the fact that on an average only 4.4% of the allocated budgetary requirements is being spent on planned capital expenditure; the resources allocated may not generate the desired result. The government need to take some very sincere and serious steps to cut down its revenue expenditure and overheads and on the other hand reduce the burden of debt servicing so that adequate resources can be allocated for infrastructure development of the country.

- All edible oils, crude as well as refined oils, roasted molybdenum ore and concentrate to be exempted from additional duty of 4%

- Scope of Customs Duty Extended as under

  - Duty of 3% imposed on Private Import of aircraft and helicopters. CV duty of 16% and special addition duty of 4% has also been imposed.

  - Export Duty of 300/- per metric tonne imposed on export of Iron Ore and concentrates.

  - Export Duty of 2000/- per metric tonne imposed on Chrome Ore and concentrates

SERVICE TAX

- No change in Service Tax rates.

- Basic exemption limit for service providers raised from Rs. 4 lacs to Rs. 8 lacs.

- Basic exemption for obtaining Service Tax Registration number raised from Rs. 3 lacs to Rs. 7 lacs.

- **New Services added**

Following 7 new services are brought under tax net :

- Telecommunication Service
- Mining Service
- Renting of Immovable Property Service
- Service involved in the execution of a works
- Development and Supply of Content Service
- Asset Management including Portfolio Management and all forms of Fund Management Service
- Design Services

- **Scope of existing services Extended added**

Scope of following services extended

- Sale of space or time for Advertisement, amended to include yellow pages and trade catalogues.

- Mandap Keeper Services, Pandal or Shamiana Services and Event Management Services: now include services provided in relation to marriage functions.

- Banking and other Financial Service:
  - ✓ The words “any other person” substituted with “commercial concern”.
  - ✓ Cash Management proposed to be included.

- Management Consultant’s Service : Renamed as management or business consultant’s service. Further the definition explicitly includes business consultancy.

- Consulting Engineer’s Service: Computer hardware engineering consultancy proposed to include in consulting engineer’s service.

- Rent a Cab Service: Renting of motor vehicle capable of carrying more than 12 passengers is included. However, renting to an educational body is exempt.

- **Exemptions**

Following Services exempted from service tax

- All taxable services provided by Technology Business Incubators (TBI) / Science & Technology Entrepreneurship Parks (STEP)

- Services provided by Resident Welfare Associations to members where monthly contribution does not exceeds Rs3000/-.

- Services provided to delivery of content of cinema in digital form after encryption electronically

- Services provided in relation to Clinical trials subject to certain conditions

1.0 PRE & POST - SHIPMENT GUIDELINES

1.1 Pre - Shipment Export Credit in Foreign Currency Guidelines :

- Authorised dealers permitted to extend Pre-shipment Credit in Foreign Currency (PCFC) to exporters for domestic and imported inputs of exported goods at internationally competitive rates of interest.

- Exporters can avail various options for credit.

- To enable operational flexibility, banks can extend PCFC in one convertible currency in respect of an export order invoiced in another convertible currency.

- The foreign currency balances available with the bank in EEFC Accounts, RFC Accounts and FCNR Accounts could be utilised **for financing the pre-shipment credit in foreign currency**. Further the foreign currency balances available under Escrow Accounts and Exporters Foreign Currency Accounts can be utilized for the purpose, provided other requirements are complied with.

- The PCFC will be available initially for a maximum period of 180 days; any extension of the credit will be subject to the same terms and conditions as applicable for extension of rupee packing credit and additional interest cost of 2 percent above the rate for the initial period of 180 days prevailing at the time of extension.

- PCFC can be liquidated out of proceeds of export documents or by grant of foreign currency loans (DP Bills), repaid /prepaid out of balances in EEFC A/c as also from rupee resources of the exporter to the extent exports have actually taken place.

- Banks permitted to extend the 'Running Account' facility under the PCFC Scheme to exporters for all commodities, on the lines of the facility available under rupee credit, subject to prescribed conditions.

1.2 Post - Shipment Export Credit in Foreign Currency Guidelines :

- Banks allowed to rediscount export bills abroad at rates linked to international interest rates at post-shipment stage as per the prescribed scheme

- The Scheme to cover mainly export bills with usance period up to 180 days from the date of shipment

- The Rupee equivalent of the discounted value of the export bills will be payable to the exporter and the same should be utilised to liquidate the outstanding export packing credit.

1.3 Gold Card Scheme for Exporters :

- Gold Card holders will be given preference for grant of packing credit in foreign currency (PCFC)

- The credit to Indian exporters holding Gold Card should be at rates of interest not exceeding LIBOR + 1.00 per cent (100 basis point)

2.0 IMPORT OF GOOD & SERVICES

2.1 Application :

Applications by persons, firms and companies for making payments, exceeding USD 500 or its equivalent, towards imports into India must be made on the appropriate Form A-1.

2.2 Import Licenses :

- AD banks may freely open letters of credit and allow remittances for import of goods unless they are included in the negative list requiring license under the Foreign Trade Policy in force.

- In such cases, licenses marked 'For Exchange Control purposes' should be called for and special conditions, if any, attached to such licenses adhered to.

- Exchange Control Copy of the import license submitted by the importer for opening a Letter of Credit or making remittance, when fully utilised, should be retained by the AD banks and may be preserved till its scrutiny by the internal auditors or inspectors is completed.

2.3 Purchasers obligation :

Use of Foreign Exchange: In terms of Section 10(6) of the Foreign Exchange Management Act, 1999 (FEMA), any person acquiring foreign exchange is permitted to use it either for the purpose mentioned in the declaration made by him to an Authorised Dealer under Section 10(5) of the Act or to use it for any other purpose for which acquisition of exchange is permissible under the said Act, or Rules or Regulations framed there under.

Furnishing Evidence: Where foreign exchange acquired has been utilised for import of goods into India the AD bank should ensure that the importer furnishes an evidence of import to his satisfaction.

Mode of Payment for import can also be made by way of credit to non-resident account of the overseas exporter maintained with a bank in India.

2.4 Advance Remittance for Imports :

AD banks may allow advance remittance for import of goods without any ceiling subject to the following conditions:

Remittance :

The remittance is made directly to the supplier or manufacturer of the goods and not to any third party or to a numbered account.

Import :

Physical import of goods into India is made within six months (three years in case of capital goods) from the date of remittance and the importer gives an undertaking to furnish documentary evidence of import within fifteen days from the close of the relevant period.

Non - Import :

In the event of non-import of goods, AD bank should ensure that the amount of advance remittance is repatriated to India or is utilised for any other purposes for which release of exchange is permissible under the Act, Rules or Regulations made there under.

Guarantee :

- Letter of Credit or Guarantee: f the amount of advance remittance exceeds USD 100,000 or its equivalent, an unconditional, irrevocable standby Letter of Credit or a guarantee from an international bank of repute situated outside India or a guarantee of an AD bank in India, if such a guarantee is issued against the counter-guarantee of an international bank of repute situated outside India, is obtained.
- In cases where the importer (other than a Public Sector Company or a Department/Undertaking of the Government of India/State Governments) is unable to obtain bank guarantee from overseas suppliers and the AD bank is satisfied about the track record and bonafides of the importer, the requirement of the bank guarantee / standby Letter of Credit may not be insisted upon for advance remittances upto USD 1,000,000 (US dollar one million). AD banks may frame their own internal guidelines to deal with such cases as per a suitable policy framed by the bank's Board of Directors.
- Waiver from Ministry of Finance: A Public Sector Company or a Department/Undertaking of the Central/State Government/s which is not in a position to obtain a guarantee from an international bank of repute against an advance payment, is required to obtain a specific waiver for the bank guarantee from the Ministry of Finance, Government of India before making advance remittance exceeding USD 100, 000.

2.5 Time limit for settlement of Import payments :

Remittances against imports should be completed not later than six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance etc.

2.6 International Factoring :

AD banks may enter into arrangements with international factoring companies of repute, preferably members of Factors Chain International, without the approval of Reserve Bank. However, they will have to ensure compliance with the extant foreign exchange directions relating to imports, Foreign Trade Policy in force and any other guidelines / directives issued by Reserve Bank in this regard.

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3.0 GUILDELINES FOR ISSUE OF CERTIFICATE OF DEPOSIT (CDs)

Certificates of Deposit (CD) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period with the objective of further widening the range of money market instruments and giving the investors greater flexibility in deployment of their short-term surplus funds.

The various guidelines issued by the RBI for issue of CDs from time to time are as follows:

- CDs can be issued by (i) Scheduled Commercial Banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) All India Financial Institutions (FIs) that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.
- Minimum amount of a CD should be Rs.1 lakh and in the multiples of Rs. 1 lakh thereafter.
- Physical CDs are freely transferable by endorsement and delivery.
- Dematted CDs can be transferred as per the procedure applicable to other demat securities.
- There is no lock-in period for the CDs.
- The maturity period of CDs issued by banks should be not less than 7 days and not more than one year.
- Banks/FIs cannot grant loans against CDs. Also they cannot buyback their own CDs before maturity.
- In case of the loss of physical certificates, duplicate certificates can be issued.

4.0 DISTRIBUTION OF MF PRODUCTS BY NBFCs

It has been decided to allow Non Banking Finance Companies (NBFCs), selectively, for marketing and distribution of Mutual Fund (MF) products as agents of mutual funds, with prior approval of Reserve Bank, for an initial period of two years and a review thereafter. NBFCs fulfilling certain minimum requirements are eligible to apply.

(Source: RBI/2006-07/195 dt. 04.12.2006)

5.0 DISTRIBUTION OF MF PRODUCTS BY NBFCs

Property developers will have to look at new methods for financing their projects specially since bank funds are slowly drying up. If they are to get funds from these new sources they will have to be more transparent, have proper reporting and monitoring procedures in place and ensure clean title deeds.

6.0 LOAN AGAINST SARES NORMS EASED

Any individual can now borrow from the banking system against security of shares and debentures of upto Rs. 10 lakh if the security is held in physical form and of upto Rs. 20 lakh if it is in the demat form. The central bank has kept the overall ceiling on a bank's aggregate capital market exposure to 40 per cent of its net worth.

7.0 NO MISSELLING SHADOW DEALS IN FOREIGN EXCHANGE DERIVATIVES

RBI has directed that the Banks would be held responsible for misselling derivatives if they enter into deal where a contract is not consistent with the user's business. RBI has also barred banks from entering into derivative deals to hedge against risk positions entered overseas. As per draft guidelines on derivatives, it is provided that market makers should carry out proper due-diligence regarding user appropriateness and suitability of products before offering derivative products to users. Each market maker should adopt a Board-approved Customer Appropriateness & Suitability Policy for derivatives business. It is also stated that a user should not have a net short-options position, either on a standalone basis or in a structured product, except to the extent of permitted covered calls and puts.

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