

Tax Hotline

February 03, 2004

INTERIM BUDGET 2004-05

In anticipation of the forthcoming elections, the Finance Minister, Mr Jaswant Singh ("**FM**") today presented the Interim Budget, for a part of the fiscal year April 1, 2004 to March 31, 2005 ("**Budget**"). This interim budget would seek a "Vote-on-Account" to enable the Government to discharge its responsibilities and to meet its essential expenditure till such time as the next Government is elected. As no significant changes can be made in the fiscal policy, most of the changes proposed by the FM are in the form of promises and commitments, which the current Government would fulfill if it is elected as the ruling party for the upcoming term of 5 years.

The FM has nevertheless addressed the current issues related to taxation of BPO companies by referring to the recent circular issued in respect of outsourcing of call center activities, long-term capital gains tax exemption for investment in certain shares, introduction of tonnage tax and has also proposed a 50% reduction in stamp duty on certain transactions.

The approach to the Budget has shown the Government's continued commitment to the five basic concerns of Indian citizens, viz. enhanced employment and eradication of poverty; a second green revolution in agriculture; infrastructure development; fiscal consolidations; and greater manufacturing sector efficiency. The policies and reforms adopted also make it abundantly clear that the focus this year as well remains on preserving the strength of India's macroeconomic fundamentals.

Kicking off with the announcement of the current inflation rate between 4-4.5 % and an expected growth rate of the GDP between 7.5-8%, the FM has proposed the following main reforms:

INFRASTRUCTURE

It has been proposed to establish four global standard international convention centers, through private and public partnership, to be located in Delhi, Mumbai, Goa and Jaipur. In order to facilitate the effective functioning of the Jaipur airport, it is proposed to convert the domestic airport into an international one. With a view to augment the water scarcity in metropolitan cities it has been decided to initiate an accelerated drinking water supply scheme for those cities by accessing funds from the Government's Infrastructure Fund, the Life Insurance Corporation and other such funding sources.

STAMP DUTY

Currently, stamp duty is levied on instruments evidencing almost every kind of transaction, which tends to increase the transaction cost considerably. This stamp duty is levied either by the Central Government or the State Government. As a first step towards rationalizing this stamp duty regime, it is proposed to reduce the stamp duty by 50% on all instruments on which stamp duty is imposed by the Central Government.

TAX

Before moving on to the tax reforms, it would be relevant to understand the impact of these proposals. Typically, the proposals made by the FM in his Budget speech, are tabled before both the houses of the Parliament for their approval, and then before the President for his consent. After receiving these approvals and making the necessary changes, the proposals become law and changes are effected in the relevant legislations. However, as discussed above, this year's Budget is simply an interim Budget. Since the Parliament will be dissolved in a few days, the current Government will no longer have the authority to legislate any proposals made by the FM. Accordingly, as stated by the FM, the Budget does not propose any changes to the legislations. Rather it simply discusses the reforms, which the Government commits to carry out at a later stage. Some of the relevant proposals are as under:

DIRECT TAXATION

- The current income tax structure is left untouched, the slab rates for individuals and the other tax rates remaining intact. However, some hope has been shown for salaried individuals by stating that standard deduction and basic exemption limits will be revisited.
- Section 80IA of the Income Tax Act, 1961 provides for a 100% tax exemption in respect of any new undertaking in the power sector starting transmission or distribution at any time till March 31, 2006. This date for setting up the new undertaking is proposed to be extended till March 31, 2012. Further, it is also proposed to extend this exemption to cases of take-over from State Electricity Boards.
- Currently long term capital gains on certain listed securities purchased between March 1, 2003 and March 1, 2004 are tax exempt. It is proposed to extend this exemption in respect of securities purchased till February 28, 2007.
- In order to make the Indian shipping business internationally competitive, a tonnage tax scheme, with notional income at a fixed rate on the basis of net registered tonnage is proposed to be considered. This is a long awaited

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reform for the shipping industry.

- The FM has referred to the recent circular of the Central Board of Direct Taxes ("CBDT") clarifying that the call center activities outsourced to India will not attract any tax. He has simply reiterated the circular by stating that if the outsourced services are ancillary and auxiliary in nature, and if the transaction between the foreign entity and the Indian BPO unit is on an arm's length basis, then the foreign entity would not be subject to any tax in India. However, he has not dealt with the issue of outsourcing other activities.

By way of background, the CBDT recently issued a circular on taxation of companies in the business process outsourcing ("BPO") space ([Please click here to view our tax hotline on the same](#)). As per this circular, where any foreign entity outsources its core business activities, then the foreign entity could be taxable in India in respect of the profits attributable to the activities carried out in India, if the Indian BPO unit forms a Permanent Establishment of the foreign company in India. However, no profits would be subject to tax in India in case the activities outsourced to India were non-core activities and fees were paid on arm's length basis.

SERVICE TAX

The FM reiterated the announcements made by him recently in January 2004 regarding there being only a simple verification for grant of service tax registration, a single registration for more than one taxable service and e-filing of service tax returns in respect of all taxable services.

INDIRECT TAX

The Government had recently announced certain notifications in January 2004 modifying the indirect tax implications on certain items and suggesting other relevant changes. Accordingly, not many changes have been proposed in the Budget.

However, it was stated that the Ministry of Finance would examine the availability of deemed export benefits to capital goods manufactured indigenously, in all cases where there is exemption from countervailing duty on similar imported goods. Further, free baggage allowance has been raised from the current Rs 12,000 to Rs 25,000. Further, the customs duty on such baggage is also proposed to be reduced from 50% to 40%.

USER-FRIENDLY TAX ADMINISTRATION MEASURES

Certain measures were announced in order to facilitate the move towards an improved tax administration through greater application of IT with lower compliance costs. This is proposed to be carried out by introducing e-filing of excise returns, round the clock electronic filing of customs documents, etc.

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