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Indian Budget for the Year 2012-2013

The Indian Finance Minister today presented the Budget for the year 2012-2013 in the Indian Parliament. While modest measures to reduce the fiscal deficit have been proposed, the Budget does not contain any radical policy changes. The Budget proposes changes to direct taxes, indicates financial sector reforms (banking, insurance and pensions) and liberalises external commercial borrowing norms for the infrastructure sector.

The Budget announcements do not include any measure for further liberalisation of foreign direct investment (FDI) limits in sectors where FDI is still regulated, although there are indications that the Government intends to liberalise FDI regimes for multi-brand retail and civil aviation. Long awaited financial sector reforms (banking, insurance and pension) are expected to be initiated this year, which may include increasing FDI limits in the insurance sector.

The country's GDP is estimated to grow at a pace of 6.9% in real terms in 2011-2012, with agriculture accounting for 2.5%, industry for 3.9% and services for 9.4% of such growth. The decline in the growth rate from 8.4% in each of the preceding two years is attributed primarily to deceleration in industrial growth and a weak global economic recovery as well as India's monetary and fiscal policy being geared towards taming the high rates of domestic inflation. With inflationary pressures easing, the Budget seeks to strengthen drivers of demand driven domestic growth and private investment with specific emphasis on infrastructure and manufacturing. The GDP is estimated to grow at a rate of 7.6% in 2012-2013.

Some highlights of this year's Budget are provided below.

Key issues

- Infrastructure spending in the period 2012-2017 up to USD 1 trillion, half of which is expected to come from the private sector
- ECB limits have been liberalised in power, aviation, roads and highways and low cost housing
- General Anti-Avoidance Rules to be introduced
- Government targets disinvestment of USD 6 billion
- QFIs to be allowed to invest in Indian bond markets
- Clarificatory direct tax amendments following the Vodafone judgment

Infrastructure

- Investment in infrastructure to be increased up to USD 1 trillion, half of which is expected to be contributed by the private sector, in the Twelfth Five Year Plan (2012-2017).
- Tax free bonds of USD 12 billion to be allowed for financing infrastructure projects in 2012-2013.
- External Commercial Borrowings (ECB) to be allowed for financing (i) the Rupee debt of existing power projects; (ii) working capital requirements of the airline industry for a period of one year up to USD 1 billion; (iii) capital expenditure for maintenance and operation of toll systems for roads and highways; and (iv) low cost housing.
- Proposal to award contracts to cover a length of 8,800 kilometres of roads and highways.
- Further sectors made eligible for viability gap funding, including irrigation, oil and gas pipelines and storage facilities and fixed networks and towers for telecommunications.

Financial sector

- Proposed capital markets reforms, including simplification of the IPO process and permitting Qualified Foreign Investors (QFIs) to invest in Indian bonds and permitting two-way conversion of Indian Depository Receipts (subject to a ceiling) to encourage greater foreign participation in Indian capital markets.
- Further capitalisation of public sector banks and financial institutions with USD 3.2 billion.
- Liberalisation of investment norms for foreign venture capital fund investments.

Disinvestment

- An amount of USD 6 billion is intended to be raised through disinvestment in the year 2012-2013. However, the Government plans to retain at least a 51% stake and management control in the central public sector undertakings which are divested.

Direct taxes

- Certain aspects of the proposed new Direct Taxes Code (DTC) are proposed to be implemented, such as a legislative framework for general anti-avoidance rules.
- Advance Pricing Agreement with the tax authority in relation to transfer pricing methodology is to be introduced. Transfer pricing norms to be modified, including enhancing certain powers of the transfer pricing officer, extending the transfer pricing regulations to certain domestic related party transactions and providing clarity on determination of arm's length price.
- Rate of withholding tax on interest payments on ECBs proposed to be reduced from 20% to 5% for certain infrastructure sectors for a period of 3 years.
- Securities transaction tax (a tax on the transfer of securities on the stock exchange) to be reduced from 0.125% to 0.1% on cash delivery transactions.
- No change in corporate tax rates.
- In the wake of the Vodafone tax judgment, the definitions of "property" and "transfer" in the Income Tax Act are proposed to be tightened.

Indirect taxes

- All services except those specifically listed under the 17 heads of the negative list to be subject to service tax.
- Proposal to raise service tax and standard excise duty from 10% to 12%.
- Input tax credit to be allowed in specific services to reduce cascading of taxes.
- Excise duty on large cars proposed to be enhanced.
- Proposed exemptions from basic customs duty for certain fuels for power generation, including steam coal, and for coal mining projects.
- Tax concessions proposed for encouraging energy-saving devices as well as plant and equipment for solar power projects.

Other policy reforms

- A consultation is currently underway between the Centre and the States to achieve a "broad based consensus" on allowing FDI in multi-brand retail up to 51 per cent.
- Proposals under consideration to allow foreign airlines to participate in the equity of a domestic airline up to 49 per cent.
- With the intention of protecting the macroeconomic fundamentals of the economy, efforts are to be made to limit central subsidies to 2% of the GDP in 2012-2013, to be further reduced to 1.75% of GDP in the next three years.

The full text of the Union Budget and related documents including the Finance Bill, 2012 may be accessed at http://www.indiabudget.nic.in/.

An indicative exchange rate of USD 1 = INR 50 has been used in this briefing.

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