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Indian Budget for the Year 2011-12

The Indian Finance Minister today presented the budget for India in the Indian Parliament. Importantly, the Government has confirmed further liberalisation in the banking sector. The budget also includes increased spending and benefits for the infrastructure and agricultural sectors.

The country's GDP grew at a pace of 8.6% in real terms in 2010-2011 with agriculture accounting for 5.4% of growth, industry at 8.1% and services at 9.6%. It is estimated that GDP growth will accelerate further and reach 9% in 2011-2012. The Budget seeks to continue to maintain this trajectory of growth with specific emphasis on infrastructure, rural development and reform in the financial sector as well as generally improving governance practices. In light of the current politico-economic situation the Budget seeks to assuage the twin concerns of inflation and corruption that have plagued this Government.

Fiscal deficit has been brought down to 5.1% of GDP as opposed to the 5.5% target set in the previous Budget. The aim is to reduce the deficit to 4.6% for 2011-2012 and further reduced to 3.5% by 2013-2014. Furthermore the Finance Minister believed that the global recovery was eventually taking root in developed economies, evidenced by exports growing by 29.4% and imports by 17.6% on a year-on-year basis.

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

1. INFRASTRUCTURE

The infrastructure outlay for 2011-2012 has been increased by a significant 23.3% to US$ 47.5 billion. Infrastructure growth is clearly a key aspect of the Government's agenda since this amount accounts for 48.5% of the total plan spend in the Budget.

The foreign institutional investors (FIIs) limit for investment in corporate bonds, with residual maturity of over five years issued by companies in infrastructure sector, is being raised by an additional limit of US$ 20 billion taking the limit to US$ 25 billion. This will raise the total limit available to the FIIs for investment in corporate bonds to US$ 40 billion.

Buoyed by the success of the 'public private partnership' (PPP) model, the Government proposes to formulate a comprehensive policy for further developing projects on this model with a view to attracting further private investment in this sector.

To help finance infrastructure development, the Government proposes to issue tax free bonds in the amount of US$ 6.7 billion.

In order to attract foreign financing the Government has proposed to create special vehicles in the form of notified infrastructure debt funds. Interest payment on the borrowings of these funds will be subject to a reduced withholding tax of 5% (instead of the current rate of 20%) and the income of these funds will be exempt from taxation.

Key Issues

Banking sector to be liberalised

Infrastructure spending increased by 23.3% to US$ 47.5 billion with fiscal and other benefits provided to increase private participation

Certain Government disinvestments to be postponed

Agriculture - measures announced to tackle wastage and improve supply chain, along with certain tax benefits

Direct Taxes Code bill to be introduced in the next fiscal year

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To support units established in Special Economic Zones (SEZs) in India, it has been proposed that units in SEZs will be able to receive tax-free receipt of services.

2. FINANCIAL SECTOR REFORM

The private and international banking industry has been demanding the further liberalisation of the banking sector and it was announced that the Reserve Bank of India will issue detailed guidelines in this regard by end-March and amendments will be made to the Banking Regulation Act.

Indian mutual funds (a form of domestic collective investment schemes) registered with the Securities and Exchange Board of India are permitted to accept subscriptions from foreign investors as long as they meet the necessary "know your customer" requirements.

In the microfinance sector, which has courted much controversy recently, the Government is considering a regulatory framework to ensure that small borrowers are protected. It will also establish an "India Microfinance Equity Fund".

The Government indicated that discussions are underway in relation to further liberalisation of the FDI policy. There was no specific announcement of changes in the FDI caps for the insurance and retail sectors, although reference was made to bringing forward the insurance bill which is expected to, among other things, address the FDI cap in the insurance sector.

A Financial Sector Legislative Reforms Committee is to be set up to rewrite and streamline financial sector laws, rules and regulations. In addition to this legislative exercise, the Government proposes to amend the archaic Indian Stamp Act and modernise the infrastructure for payment of stamp duties. The Government has also indicated major amendments to pensions, insolvency and banking regulation.

The Companies Bill introduced in Parliament in 2009 will be introduced in the Lok Sabha (Lower House) during its current session.

3. DISINVESTMENT

The Government has decided to postpone some disinvestments that were planned for 2010-2011.

An amount of US$ 8.9 billion is intended to be raised through disinvestment in the year 2011-2012. However, the Government plans to retain at least a 51% stake and management control in the central public sector undertakings which are divested.

4. AGRICULTURE

An important theme of the Budget was to encourage socially inclusive growth by placing prominence on agriculture and rural development in light of India still being primarily an agrarian society.

To tackle the issue of wastage of agricultural produce the Government is keen to augment storage capacity and "cold chains" and has given such projects infrastructure status so as to enable such projects to avail benefits available to infrastructure projects in India. Capital investment in this area will be eligible for viability gap funding by the Finance Ministry.

The Government also expressed an intention to bring efficiency into the agricultural supply chain. Improved and more direct access to producers by organised retail has been a long standing demand and should benefit producers, consumers and the organised retail sector.

5. DIRECT TAXES

The Government announced that the Direct Taxes Code Bill will be introduced in the Parliament in the next financial year following the end of the ongoing consultation process.

The rate of surcharge applicable over and above the basic rate of taxation for domestic companies has been reduced from 7.5% to 5%.

The Minimum Alternate Tax (MAT) (a tax paid by companies on their book profits) has been increased to 18.5% from the earlier rate of 18% (both rates are exclusive of applicable surcharge and education cess). MAT will be levied on developers as well as units operating in SEZs. The MAT was earlier introduced to ensure that profitable companies having no tax liability because of exemptions/ deductions available under the tax law, pay some tax to the exchequer.

Some tax benefits have been announced in the agriculture, infrastructure, innovation and affordable housing sectors in keeping with the theme of the Budget.

6. INDIRECT TAXES

India being a federal polity, the consultation with the state governments for the implementation of the much awaited Goods and Services Tax (GST) is still ongoing. The Government will introduce a constitutional amendment as a step in this direction and it is envisaged that the GST would be implemented by mid-2012.

To assist the agricultural sector, equipment needed for storage and warehouse facilities of agricultural produce have been exempted from excise duty and basic customs duty on specified agricultural machinery has been reduced.

To encourage 'green technology' the Government has granted various exemptions and concessions in relation hybrid vehicles, electric vehicles and solar lanterns among others.

The full text of the Union Budget and related documents including the Finance Bill, 2010 may be accessed at http://www.indiabudget.nic.in/