PRE BUDGET VIEWS

We Expect a Slightly Higher Tax Rate for Industry While the Exemptions May Increase For Individual Tax Payers

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As the Indian budget 2011-12 approaches, the Indian growth story is being challenged by the issues of inflation and the twin deficits; fiscal deficit and a perceived governance deficit at the Centre. On the one hand inflation has beaten the consensus expectations of a steady base effect induced decline and has surprised most on the upside. On the other, a consistent and seemingly regular flow of corruption scams has been consistently grabbing headlines. The government thus finds itself boxed from all sides; inflation, scams, common man's increasing dissatisfaction on price rise, low levels of coordination within various ministries and an opposition on the offensive. The 2011-12 budget therefore assumes a very high level of importance for the markets. Markets shall keenly watch out for signals of Government's seriousness to tame inflation, willingness to control fiscal deficit and at the same time its efforts to form a conducive environment for business and industrial growth.

Since inflation is mainly due to supply side problems from food articles, we expect the government to take a host of measures that would improve the supply of food articles. This is likely to include measures to promote cold chain storage and cold chain logistics in the country, improve agricultural yields, increase mechanization in farming and support to poultry sector.

On the fiscal deficit side, we do not expect the Government to meets its FRBM target of fiscal deficit at 4.8% of GDP in FY12. Government's expenditures on social sector schemes such NREGA, National Rural Health Mission, JNNURM, etc are structural in nature and cannot be reversed. High inflation and high global commodity prices are likely to keep the pressure on the government to continue or even enhance subsidies. Additionally the one-offs of 3G and wireless broadband spectrum auction too shall not be available this time around.

Therefore, forced with a sticky expenditure side, the government is likely to focus more on enhancing its revenues. This can be through reducing the number of exempt industries in the Union Excise Act, increasing the number of services coming under the purview of service tax, higher excise duty on industries where excise tax was lowered during the global crisis, temporary cess to fund social spending, higher tax on cigarettes & liquor and a higher disinvestment target. Considering the recent brouhaha about black money, the Government may also be tempted to introduce a tax amnesty scheme for black money in foreign bank accounts, which will also help boost revenues in the short term.

To counter the perception of governance deficit, we expect the government to announce a slew of high visibility measures to promote FDI in India. The insurance sector could be a key beneficiary of the Government's decision to increase the cap on foreign holding. We also expect the government to announce a one year extension to the EOU and STPI schemes in order to promote exports in a weak global environment. We expect announcement of additional measures to promote the export sector.

On direct taxes front, the current budget may see an increase in the exemption limit for lower income group as government tries to soothe the common man's pain. On the corporate tax side, MAT rate of tax could up further this year as the Government looks at ways to expand its revenues.

In conclusion, we expect taming inflation and inclusive development to remain the twin over-arching objectives of the Budget, with some thought given to the fiscal deficit. We expect high visibility measures on economic reforms and promotion of industrial growth. We expect a slightly higher tax rate for industry while the exemptions may increase for individual tax payers. Hopefully, the Finance Minister will also announce some credible steps to improve the quality of public expenditure and concrete steps to complete unfinished agendas like relaxation in FDI, development of a corporate bond market and infrastructure development.

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