A Publication of the Embassy of India, Washington, D.C.

Budget Bulletin

www.indianembassy.org

2005-06

Highlights of the Budget

- Growth rate in 2004-05 estimated to be 6.9 percent, with the manufacturing sector expected to grow at 8.9 percent.
- Peak rates of Customs Duty for non-agricultural products reduced from 20 percent to 15 percent.
- Corporate Income Tax on domestic companies reduced from 35 percent to 30 percent.
- Customs Duty on selected capital goods and parts thereof reduced to 10 percent and 5 percent rates.
- 108 items identified for dereservation for small-scale industries.
- Personal Income Tax structures further simplified.
- National Rural Employment Guarantee Scheme launched with allocation of Rs. 110 billion.
- RBI unveils Roadmap for Presence of Foreign Banks in India and Guidelines on Ownership and Governance in Private Banks.
- Budget Deficit on target at 4.3 percent of GDP.
- All States have agreed to include a two-level Value Added Tax from April 1, 2005.
- A programme at an estimated cost of Rs. 102 billion for Tsunami Reconstruction and Rehabilitation.
- The exemption from tax on interest earned on accounts maintained by Non Resident Indians to continue.

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Finance Minister P. Chidambaram in his Budget Speech stated that he intends to advance the Government's declared policy of making the customs duty structure closer to that of East Asian countries. He proposed to reduce the peak rate for non-agricultural products from 20 percent to 15 percent. Last year, India had reduced peak customs duty from 25 percent to 20 percent and had also abolished Special Additional Duty (SAD) of 4 percent levied in lieu of State Sales Tax. In one year time, effective import duty in India is being reduced from 29 percent to 15 percent on a roadmap to bring them down to East Asian levels.

The Budget 2005-06 also proposes to bring down the customs duty rates on capital goods and raw materials as well as correct any inverted duty structures. The Finance Minister has proposed to reduce the Customs Duty on selected capital goods and parts thereof to below 15 percent, to 10 percent in some cases and to 5 percent in some others.

Main highlights of duty reductions on capital goods

- Duty on textile machinery to be reduced from 20 percent to 10 percent.
- Duties on seven specified machinery used in leather and footwear industry, to be reduced from 20 percent to 5 percent.
- Duty on nine specified machinery used in pharma and biotech sectors to be reduced to 5 percent.
- Duties on primary and secondary metals to be reduced from 15 percent to 10 percent; industrial raw materials such as catalysts, refractory raw materials, basic plastic materials, molasses and industrial ethyl alcohol to be now liable to a reduced customs duty rate of 10 percent; duty on lead to be reduced to 5percent.
- Duty on coking coal with high ash content to go down to 5 percent.
- Duty on polyester and nylon chips, textile fibers, yarns and intermediates, fabrics, and garments to be reduced from 20 percent to 15 percent.
- Duty to be removed on specified capital goods and all inputs required for the manufacture of Information Technology Agreement (ITA) bound items.
- A CVD of 4 percent only to be levied on the imports of ITA bound items and their inputs that attract nil duty; credit for the CVD to be available against payment of excise duty; IT software to be exempt from the proposed CVD.

Excise Duty Reductions

- Excise Duty on polyester filament yarn, tires and air conditioners to be reduced to 16 percent.
- Excise Duty on Iron and Steel to be reduced to 16 percent.

Taxes on petroleum products

- Customs duty on crude petroleum to be reduced from 10 percent to 5 percent.
- Customs duty and excise duty to be nil on LPG for domestic consumption and on subsidized kerosene.
- Customs duty on other petroleum products, including motor spirit (MS) and diesel (HSD) to be reduced from 20 percent or 15 percent to 10 percent; excise duties on petrol and diesel to be fixed as a combination of ad valorem and specific duties.

Banking

Amendments to be introduced to the Banking Regulation Act and the Reserve Bank of India Act:

- to remove the lower and upper bounds to the statutory liquidity ratio (SLR) and provide flexibility to RBI to prescribe prudential norms;
- to allow banking companies to issue preference shares;
- to remove the limits of the Cash Reserve Ratio (CRR) to facilitate more flexible conduct of monetary policy.

Roadmap for Foreign Investment in Indian Private Banks

On 28th February 2005, RBI released the roadmap for presence of foreign banks in India. Foreign banks may operate in India through only one of the three channels, namely (i) branch/es (ii) a Wholly owned Subsidiary or (iii) a subsidiary with an aggregate foreign investment up to a maximum of 74 percent in a private bank.

The guidelines issued by RBI cover, inter alia, the eligibility criteria of the applicant foreign banks such as ownership pattern, financial soundness, supervisory rating and the international ranking. During this phase, permission for acquisition of share holding in Indian private sector banks by eligible foreign banks will be limited to banks identified by RBI for restructuring. RBI may, if it is satisfied that such investment by the foreign bank concerned will be in the long term interest of all the stakeholders in the investee bank, permit such acquisition.

Text of the guidelines is available at http://www.rbi.org.in

Capital Market

- FIIs to be permitted to submit appropriate collateral, in cash or otherwise, as prescribed by SEBI, when trading in derivatives on the domestic market.
- Definition of 'securities' under the Securities Contracts (Regulation) Act, 1956 to be amended so as to provide a legal framework for trading of securitized debt including mortgage backed debt.
- SEBI to be asked to permit to introduce Gold Exchange Traded Funds (GETFs) with gold as the underlying asset, in order to enable any household to buy and sell gold in units.

OTHER PROPOSALS

- VAT: All States have agreed to introduce the Value Added Tax (VAT) with effect from April 1, 2005.
- Defence Expenditure: Allocation in 2005-06 increased to Rs. 830 billion, including Rs. 343.7 billion for capital expenditure.
- Small and Medium enterprises: 108 items identified for dereservation.

INFRASTRUCTURE

The Budget places high emphasis on improvement of urban and rural infrastructure including telecommunications, highways, rural electrification, housing and urban infrastructure.

National Highway Development Project:

- NHDP III to be launched in 2005-06 to target selected high density highways not forming part of the Golden Quadrilateral or the North-South and East-West corridors; Rs. 14 billion provided in 2005-06 to four-lane 4000 kms; a special package for the North Eastern region with allocation of Rs. 4.5 billion
- In order to raise additional resources for the National Highways Development Project, cess on petrol and diesel to be increased by 0.50 Rupee per litre.
- Special Purpose Vehicle: A financial Special Purpose Vehicle (SPV) to be established to finance infrastructure projects that are financially viable; SPV to lend funds, especially debt of longer term maturity directly to eligible projects to supplement other loans.
- National Urban Renewal Mission: To cover the seven-mega cities, with a population of over a million and some other towns; outlay of Rs. 55 bn in 2005-06 including a grant component of Rs. 16.5 billion.

BHARAT NIRMAN

The Government of India has outlined an overarching vision to built India, and called it 'Bharat Nirman'. Bharat Nirman has been conceived as a business plan, to be implemented over a period of four years, for building infrastructure, specially in rural India. The goals to be achieved under Bharat Nirman by the Year 2009 are:

- to bring an additional one crore hectares under assured irrigation;
- to connect all villages that have a population of 1000 (or 500 in hilly/tribal areas) with a road;
- to construct 6 million additional houses for the poor;
- to provide drinking water to the remaining 74,000 habitations that are uncovered;
- to reach electricity to the remaining 1,25,000 villages and offer electricity connection to 23 million households; and
- to give telephone connectivity to the remaining 66,822 villages.

Direct Taxes

The new tax brackets and the new rates for personal Income Tax to be:

Up to Rs.100,000	nil
Rs.100,000 to Rs.150,000	10 per cent
Rs.150,000 to Rs.250,000	20 per cent
Above Rs.250,000	30 per cent

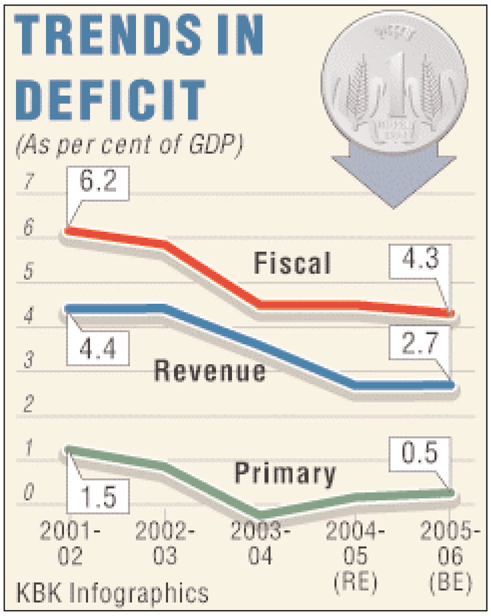
- Level at which the surcharge of 10 % will apply to be raised to Rs.1.0 million taxable income.
- Every tax payer to be allowed a consolidated limit of Rs.100,000 for savings which will be deducted from the income before tax is calculated; all prevailing sectoral caps to be removed;
- The exemption from tax on interest earned on accounts maintained by Non Resident Indians to continue.
- For domestic companies, the corporate income tax rate to be 30%; plus a surcharge of 10%;
- Withholding tax on technical services to be reduced from 20% to 10%
- Tax exemption on agreements to acquire aircraft or aircraft engines on lease to be extended up to September 30, 2005
- As a measure of facilitation, large taxpayer units (LTUs) to be established, to begin with, in major cities
- Securities Transaction Tax (STT) is proposed to be increased to 0.02 % from 0.015%.

Revenue and Fiscal Deficit

The Budget for 2005-06 estimates the total expenditure at Rs. 5,143 billion, total Revenue Receipts for the Central Government at Rs. 3,512 billion and the Revenue Expenditure at Rs. 4,465 billion.

Consequently, the Revenue Deficit is estimated at Rs. 953 billion, which is equal to 2.7 percent of the estimated GDP. The Fiscal Deficit is estimated at Rs. 1511 billion, which is 4.3 percent of the estimated GDP.

The fiscal responsibility and Budget Management Act requires a reduction in the two ratios, respectively, of 0.5 percent and 0.3 percent every year. Finance Minister announced that Government of India would achieve this degree of fiscal correction in 2004-05 and the year is expected to end the revenue deficit of 2.7 percent and a fiscal deficit of 4.5 percent of GDP



Tsunami Reconstruction and Rehabilitation Programme

Government has approved Relief Packages amounting to Rs. 36 billion. The Planning Commission, which is coordinating the Tsunami Reconstruction and Rehabilitation Programme, has drawn a programme at an estimated cost of Rs. 102 billion.

Text of the Budget is available at http://indiabudget.nic.in

(Dollar/Rupee rate as on Feb 28 2005: 43.64)

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Reactions to the Budget

Jagdish Khattar, Managing Director, Maruti Udyog Limited: This is a good Budget. The idea of 50 paise cess on petrol to fund highway development is good because roads are vital to economic growth. Then, the cut in income tax and other taxes will increase disposable income in the hands of individual, and that will push up demand, which in turn will help economic growth.

Rahul Bajaj, Chairman and Managing Director, Bajaj Auto: Overall this is a good Budget. I would rate it 8 out of 10. It takes forward reforms, does not impose additional taxes. The cut in taxes if good because that will push up purchasing power, which will push up demand, and that will help the economy.

NRIs, rejoice! NRI interest to be tax-free

Onkar Singh Kanwar, President, FICCI: I must compliment the Finance Minister for doing an excellent job within constraint resources. He has made good attempt in meeting most of the suggestions that FICCI made. He has reduced the Corporate Tax, Excise to give boost to their Indian industry.

CII, DG, N. Srinivasan: We are happy that Corporate Tax has been brought down to 30 percent.

***Reuters*:** Foreign funds upbeat as India Budget target growth- There is good long-term support for growth; infrastructure spending said Hong Kong based Jon Thorn, Fund Manager at India Capital Management HK. Analysts said that the focus on infrastructure, reduced Corporate Taxes and low duties on raw materials would boost corporate earnings. It should generally keep investors sentiment buoyant as it helps promote cost reductions everywhere said V. Anantha Nageswaran, Fund Manager, Libran Global Macro Fund, Singapore.

SENSEX zooms 144 points to 6714

The late noon trades witnessed a steep rally in Bombay Stock Exchange as across the board buying support ended the session with SENSEX at an all time closing high of 144 points at 6714. Stocks of Banks, tyre companies, construction, textile, oil and sugar were in the limelight